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CIMA E3
Strategic Management

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OVERVIEW OF PAPER E3

The syllabus consists of the following sections

A	The strategy process	This looks at how strategies can be developed. Probably the commonest approach is the 'rational model' where an organisation collects information about its environment, competition and customers, looks at its own resources and competences and tries to work out how these can be used to indicate a successful strategy.
B	Analysing the organisational ecosystem	Ecosystem' is a biological term referring to the environment in organisms exist, the resources they consume, their competition for existence and what adaptions might have to be made to maximise the chance of survival.
C	Generating strategic options	For example, expand internationally, move up-market, New markets, new products, diversification are all options.
D	Making strategic choices	The best approach is to consider feasibility, acceptability and suitability.
E	Strategic control	Strategic control implies setting targets and monitoring progress towards those targets. Additionally, employees must be motivated to embrace any strategic plan so change management is important.
F	Digital strategy	Digital technology will form a large part of most organisations' strategies. A knowledge of digital technologies is needed together with measurements relating to the success of digital innovations.

Chapter 1

REAL LIFE EXAMPLES

1. Introduction

Before we start looking at the theories of strategic planning, it might be worthwhile looking at some well-known companies and how they have fared in the past.

2. Volkswagen

Volkswagen (VW), a German car company, admired for its engineering and designs, had a fine reputation....until 2015 when the US Environmental Protection Agency issued a notice claiming that VW had violated the Clean Air Act by activating emissions controls only whilst vehicles were being tested.

VW suffered a huge reputational damage, a huge fall in its share value and will be pursued by regulators throughout the world for compensation and damages.

It is not clear why the company decided to cheat

The company was also, arguably, slow to develop hybrid and electric vehicles and may have lost ground there to other manufacturers.

3. TV companies

Not that long ago, the only way to enjoy new programmes was to wait patiently each week until the next episode was broadcast. Now, companies like Netflix and Amazon produce their own programs which are delivered on-demand over the Internet.

This new approach (and the wealth of the new production companies) has severely undermined the business models of traditional TV companies.

4. Nokia and Blackberry

In 2000, Nokia was the best-selling mobile phone brand. With the arrival of the Apple iPhone and other smart phones, Nokia quickly lost its dominance and is now a very small presence in the phone market. Similarly, Blackberry was a very strong niche player in the business communications market (its phones had a small keyboard and offered high security) with 2011 sales of about 50m units; 2016 sales were about 2m units.

Both companies suffered from the march of technology including operating systems such as iOS and Android. The new technologies allowed other companies to design and sell phones which users found much more attractive.

5. Banks

Cavalier banks are widely blamed for the 2008 economic crash. Unwise loans were made with little security; there was widespread speculation in futures and options markets. Then the house of cards fell. Famously, Leyman Brothers collapsed.

Regulators stepped in to insist on safer banking practices and, increasingly fintech companies (ie financial technology) such as Revolut, crowd-funding and cryptocurrencies (such as Bitcoin)are challenging the traditional banking model.

Chapter 2

STRATEGIC PLANNING MODELS

1. What is a 'strategic plan'?

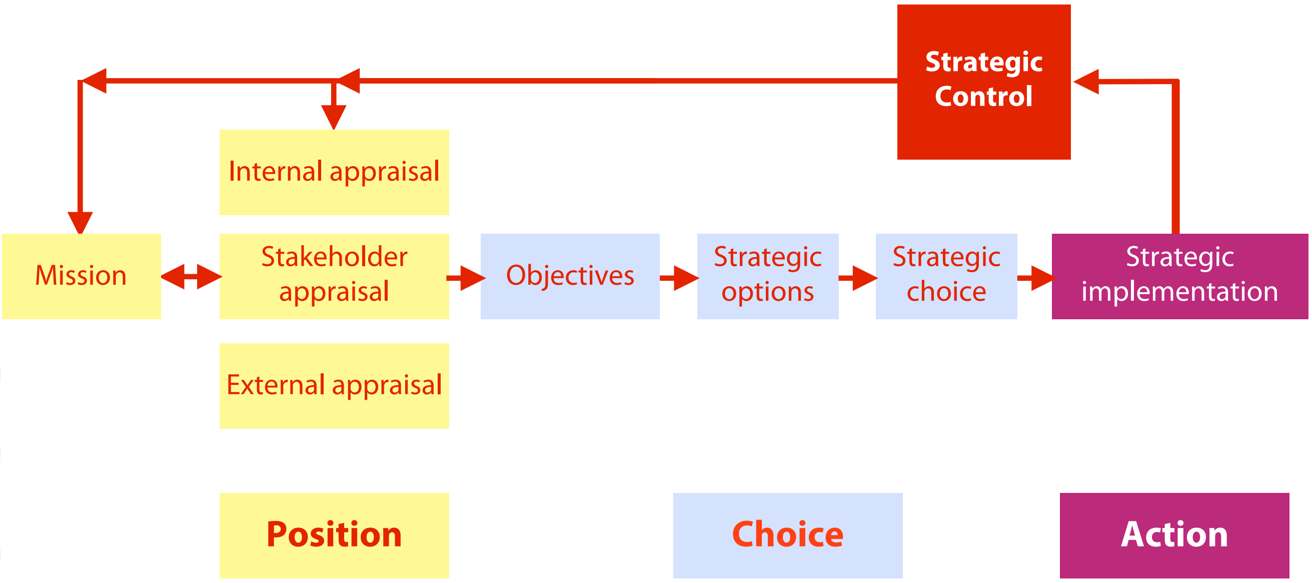
The term 'strategic plan' typically refers to a long range plan (at least three years, and often for five or longer) and often affecting the whole of the organisation. It should be addressing questions such as what the organisation will be doing and what it will look like in terms of size, structure , IT products etc in, say, five years. Some organisations use the alternative names of 'long range plan' or 'corporate plan' instead of 'strategic plan'.

Strategy can apply to different levels or parts of an organisation. For example:

- Corporate strategy: main product ranges, countries in which the company operates, manufacturing or service, where to locate manufacturing plants.
- Product strategy: for example, whether to specialise in cheaper, more basic products or whether to move up-market. Should the company extend its range of products of reduce the range?
- Digital strategy: should the company move most of its operations onto the internet and close down physical outlets? What use should be made of social media? What information about customers or potential customers should be collected and stored? What use should be made of customer information?
- Human resources strategy: how does the organisation ensure that it has enough employees of the right ability with the right qualifications to allow the organisation to fulfil its strategic plans for customer growth and product development?

2. The rational model

2.1. Diagram



2.2. Position

The rational model is an approach to strategic planning which first investigates the position of the organisation. Nowadays this might be called the 'eco-system' of the organisation. To establish the organisation's position means carrying out of an internal appraisal, an external appraisal, and also an appraisal of stakeholders, that is, an appraisal of the various parties affected by the organisation and what they want from it. This stage is information gathering.

The external elements can be referred to as the corporate ecosystem. An ecosystem is the collection of organisations (suppliers, customers, competitors, governments, economies etc) in which the organisation operates. Parts of the eco-system affect each other and organisation have to continually adapt if they are to thrive. For example, a university makes a discovery and this can then affect suppliers (whose components might be able to make use of the discovery), the company itself will be affected and customers might benefit. Competitors will need to react too to maintain their market position. Governments might impose new controls and standards to maintain safety and efficient markets.

2.3. Choice

Once the current position has been established, the organisation can go on to set objectives. The objectives must take into account, for example, what the economy is doing, what competitors are doing, and what the organisation's resources will allow it to do. The objectives are what you want to achieve; the strategy, or strategic options, are how you might go about achieving that. For example, if the objective was to increase profits by 20%, one strategy might be to take over another company.

An alternative strategy might be to expand abroad. A third strategy which could possibly generate the required profit growth might be to subcontract much of the production activities. Once the strategies have been set out and examined, one can be chosen. This will often be a compromise, for example, between high risk and high return or lower risk and lower return. A powerful method of choosing a suitable strategy is to look at its suitability, feasibility and acceptability. This will be covered more fully later.

2.4. Implementation

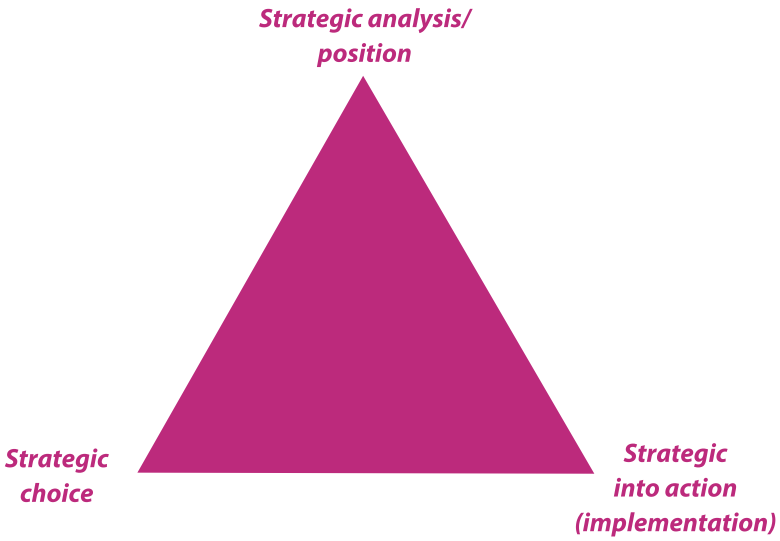
The third stage is the action stage: strategic implementation. Everything up to here has been investigation and high level planning. Too often, perhaps, organisations feel that is enough, but without implementation of the plans, strategic analysis is a waste of time and effort. Strategic implementation is hard, sustained work. As explained above, usually strategic plans will have planning horizons of five years or so, and look at the whole organisation. Strategic plans are therefore high-level documents, but implementation is a matter of detail. The strategic plan has to be broken down by department and by year. Often these small parts of the strategic plan can be regarded as discrete projects. The project objectives and constraints can be communicated by budgets, given to each department or cost centre.

2.5. Control

If every department meets its budget the strategic plan will be realised. However, it rarely is. Not only are there inherent difficulties in the planning process, but almost certainly the environment will change, and what had been a good plan will have to be modified. This is where strategic control comes in. The plan must be continually reviewed to see if it is still relevant; also we must try to make sure the performance is appropriate.

3. Rarely linear

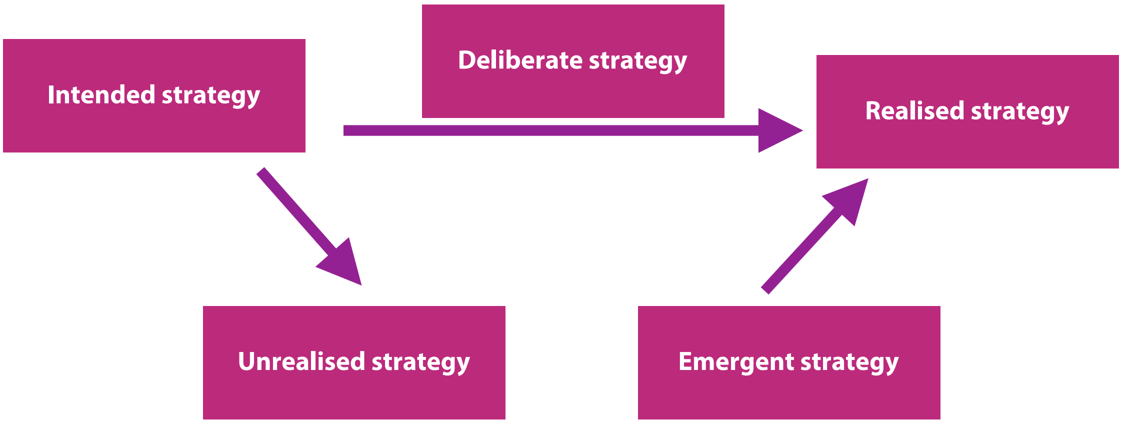
The previous diagram and narrative presented strategic planning as a linear process beginning with strategic position or analysis, then moving to strategic choice, and then turning the strategic choice in action. The following diagram simply illustrates that a linear process may oversimplify matters.


Strategic analysis/ position
Strategic choice
Strategic into action (implementation)

For example, once you begin implementing a strategy inevitably you find out more information and this may mean that you go back and review your strategy and make different choices. The three stages are inevitably linked and inform one another.

4. Rarely unchanging

Strategies should never be set in a stone. No one is capable of gathering all the relevant fact and making correct predictions. Random local, national and world events will intervene and mess up a carefully thought out strategy.



The terminology on this diagram is as follows:

- Intended strategy was the original plan.
- Usually some parts of that are unrealised. They are abandoned either because there are changes on the environment, or we find that we don’t have the resources to carry them out.
- Deliberate strategy is what you intended to do and actually did.
- Emergent strategies become apparent as time passes and new opportunities or threats have to be dealt with. This is the most important term in the diagram.
- The realised strategy is therefore the result of some strategies which were planned from the start, some strategies which were abandoned, and additional strategies which gradually emerged over the planning horizon.

The fact that the realised strategy will rarely be the same as the intended strategy does not mean that there must be a fault in the strategic planning process. It simply indicates that, obviously, the future is not perfectly predictable.

5. Logical incrementalism

Not everyone agrees the five-year rational plan is a proper approach to strategic planning. Adherents to incrementalism say that strategy should be small extensions of past policies. They maintain this view because they claim:

- It will be very unusual for strategic managers carefully to evaluate all options as it would be very difficult and time-consuming to do so. If all options and outcomes have not been evaluated, it would therefore be dangerous to embark on, and perhaps get locked into, a long-range strategic plan.
- It is unlikely that managers know all the relevant facts. This is known as bounded rationality. If you don't know all the facts, you can't evaluate all options. There are the 'known unknowns', such as your competitors' plans. You know there are plans but don't know what they are. There are the 'unknown unknowns' such as random events that no-one can predict. For example, the Japanese tsunami that inundated the Fukushima nuclear power station meant that some countries abandoned their plans for nuclear power stations. What is the point in detailed long-term planning when it is based on inevitably incomplete information?

Therefore, to say that you have plan for five years is a type of arrogance. It would be better making small logical adjustments as time goes by.

6. Freewheeling opportunism

The ultimate anti-planning stance is held by freewheeling opportunists. Followers of this approach do not like planning. Just as some people when going on holidays like to know exactly where they will be each night of the holiday. Others find such detailed planning anathema and that planning restricts the freedom of action. Freewheeling opportunists are often entrepreneurs. These people are going to starting businesses, but then tend to lose interest once the business matures somewhat and each day-to-day careful administration.

Although their dislike of planning probably lies deep within their psychology freewheeling opportunists will tend to justify their stands by claiming that planning imposes restrictions on the development of their organisations. They say it is much better not to plan too carefully and to grab good opportunities as they arise. Of course, a lack of planning can lead you into difficulties. Many entrepreneurs launch into businesses which turn out to be unsuccessful and which perhaps they would have avoided if they had better thought things through and planned more carefully. On the other hand, they are to be saluted. These are the people who often take a chance and who are often responsible for new and unexpected businesses which grow quickly and successfully.

Freewheeling opportunists can make decisions very quickly, but they might not have investigated the facts fully and thought through the implications.

7. The advantages of strategic planning

The main advantages of strategic planning are as follows:

- It establishes long-term objectives to the organisation and plans how those objectives can be achieved. Most organisations, and particularly the people working in them, like to know what's expected of them. Well-established objectives can be very motivating.
- The organisation is much better coordinated. If there were no planning, then production and sales and distribution could all be for different volumes. For the people working in an organisation there is a feeling of satisfaction and safety if you believe that there is a rational mind behind it and that it is well coordinated.
- Strategic planning usually means long-term planning and there are many developments which inevitably take a long time to realise. If people are always concentrating on their short-term objectives then it can be difficult for them to attend to long-term projects. A long-term plan can help people to be patient.
- Management shouldn't simply be passive. If they see something unfavourable that might be happening they can try to change that. For example, a proposed new law might be susceptible to political lobbying, or something happening in the marketplace could perhaps be changed by clever advertising. If you don't look into the future you will always be reactive. If you do look into the future it gives the opportunity to be proactive.
- The organisation is forced to look ahead. Not every development will be properly anticipated but surely making some effort to look ahead is better than stumbling forward with your eyes closed, being constantly surprised.

8. Potential disadvantages of strategic planning

The potential disadvantages of strategic planning are, perhaps not absolute disadvantages of planning, but more a result of how the planning processes is implemented.

- Too much time can be spent planning and not enough time to spend on action. This is paralysis by analysis. Remember nobody makes profits out of planning; profits only come from action. Some people postpone making decisions (and so exposing themselves to risk) by wanting more and more information and planning.
- Unwillingness to adapt. Some people stick to a plan no matter what. This is plainly ridiculous. No plan will remain appropriate over a time horizon of something like five years. It is essential that people are prepared to abandon parts of a plan which become inappropriate and to take on new opportunities as it become available. Retaining the capacity to be flexible should be part of planning.
- Planning has a real costs and time and money. 10 people sitting in a planning meeting for a day, represents 2 person weeks. That sort of resource allocation soon becomes material.

Remember, planning is a means to an end, not an end in itself.

Chapter 3

THE RATIONAL MODEL IN MORE DETAIL

We return now to look at the rational model and to consider each of its elements in more detail.

1. The mission

An organisation's mission is what it perceives its purpose to be. It could be an airline, a hospital, a chain of supermarkets, or a school, but all need to know why they exist and what they are for.

Nowadays it is relatively common for organisations to issue mission statements. These are short statements (no more than a page of A4) that set out the organisation's purpose and its position. For example it might be a supermarket which specialises in lower quality, lower cost goods; or it might be a supermarket which tends to specialise in higher-priced luxury goods. Those positions will often subtly be suggested in the mission statement which might make reference to value for money or quality and choice. In addition, most mission statements have several paragraphs dealing with values, culture, and ethics.

It is crucial that an organisation is clear about its mission when it comes to comes to setting its objectives, designing performance measurement systems, prioritising tasks, and setting its long-term objectives. Mission should feed into the company's value chain: how does the organisation create value for its customers?

For example:

- Company A might have a mission to product products of the highest possible quality and reliability. If that's its purpose then it should set objectives for quality and assess performance in ways that assess quality. Long term, its strategy might rely on developing new products that have better performance characteristics.
- Company B might have a mission to produce products with low unit costs for customers. If that is its purpose then it should set objectives that measure cost performance, perhaps comparing to competitors' performance. Long term, its strategy might rely on high automation or even moving production to a low cost environment.
- A not-for-profit hospital would have a mission that emphasises health care and this inevitably influence its objectives, performance measures and long term decisions about how it delivers what it sets out to do.

In addition to the term 'mission', some writers (and syllabi) make a big thing of the terms:

- Purpose
- Vision
- Values

Whether agonising over the precise meaning of these terms improves an organisation's performance had not been proved. To give some idea of how their meanings might differ, try the following:

- **Purpose:** why the organisation exists. Try starting a statement of an organisation's purpose by the phrase "We believe…….".
- **Vision:** the difference that will be made to customers (or the world!) when the purpose is realised. Try starting with "We will…."
- **Values:** the principles that you hold dear and within which the purpose and vision must reside. Try starting with "Be are committed to…", "We will continually innovate…", "We search for sustainability..", "We cherish our customers…".

As stated above, the mission statement will often embody all of these ambitions and worthy thoughts.

2. Stakeholders

Stakeholders can be defined as anyone affected by the organisation. It's important to know who your stakeholders are and what they want, because if the stakeholders are unwilling to cooperate you may find it difficult to put a strategy into action.

2.1. Stakeholders include:

- Shareholders
- Employees
- Managers/directors
- Suppliers
- Customers
- Competitors
- The government
- The local community

Stakeholders can be classified as:

Internal	Directors, managers and employees
Connected	Shareholders, lenders, suppliers, customers
External	Government, local populace, pressure groups, trade unions, non-governmental organisations, regulatory agencies.

The important thing to realise about most stakeholders is that what they want is often in conflict. For example shareholders want more profits, but employees want higher wages. Customers may want operations 24 hours a day, seven days a week, but employees might want to work only eight hours a day, five days a week. Customers want lower prices and higher quality; shareholders want lower costs so that the profits are higher. Regulatory agencies want compliance, but employees might prefer to cut corners.

Management therefore has to try to keep most people happy most of the time. To do this management has to enter into a series of negotiations with stakeholders. What's the minimum pay raise that will attract and keep employees, and stop from going on strike? What's the minimum quality and maximum price that customers will be prepare to pay before they abandon us and go to our competitors? If the local people are being harmed or in some way inconvenienced by our operations, what can we do to try to keep them onside?

There are no easy answers to this. Management has to recognise the conflicts that exist between stakeholders and try to manage them as best they can. We will also find that stakeholders are important when we come to decide which strategies might be best. The strategies have to be one which the shareholders wanted to pursue, but they also have to be strategies which other stakeholders are willing to follow. For example there is no point in adopting a strategy which means that customers abandon you, or employees leave, or a pressure group creates bad publicity.

Rather than perceiving stakeholders as nuisances (complaining customers, pernickety regulators, or employees who are quick to take industrial action) it might be better to try to form strategic alliances so that potential conflicts between stakeholders are subordinated to a common cause and mutual dependence:

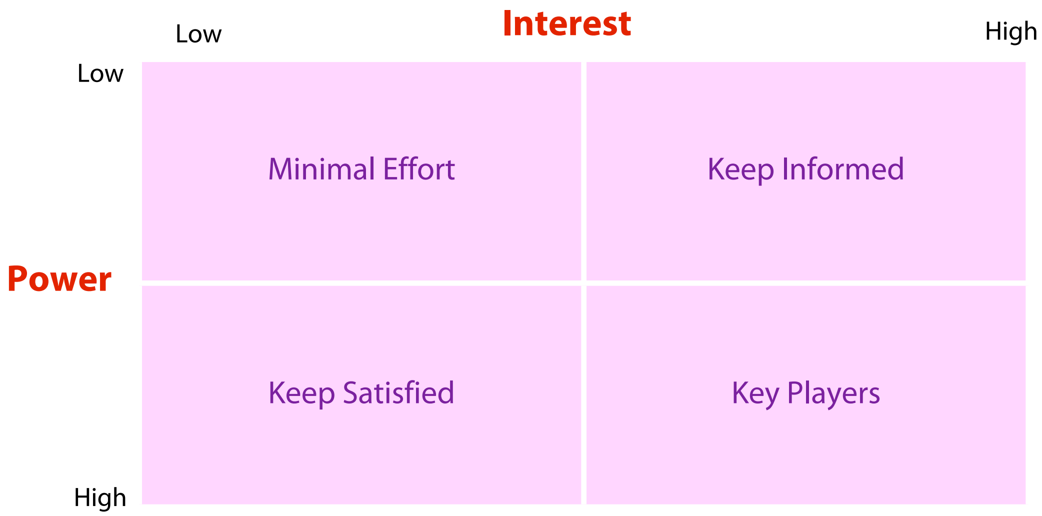
- The company needs customers but they need reliable suppliers with whom the can get on.
- Regulators are there to ensure the law is upheld. The company might not like the regulations but those should be changed through legislation rather than a stand-off with regulators.
- The company needs to attract and retain good employees and employees want employment which pays a reasonable salary and which offers reasonable conditions and the hope of advancement.

None of the above is to say, of course, that a company should immediately give into all demands.

3. Mendelow's matrix

About the only tool or model available for the analysis of stakeholders is Mendelow's matrix. This sets out:

- The power that the stakeholder can wield. For example, by being a large shareholder, by the operation of law (government), by charisma (the head of an influential pressure group), by financial means (for example a major customer
- The stakeholders' interest, by which we mean how likely is it that the stakeholder will take action: how active or passive are they? High interest means that the stakeholder will create a fuss if not pleased with what the organisation is doing.


Interest
Power

	Low	High
Low	Minimal Effort	Keep Informed
High	Keep Satisfied	Key Players

- Key players:

  Stakeholders who have high power and high interest are known as key players. Management really needs to keep those people happy. They have the power and they have the willingness to do something about it if they are upset. These stakeholders can stop any strategy in its tracks.

- Keep satisfied:

  Some stakeholders have high power but they are unlikely to take action even if management does something which they dislike. They may be unwilling to take action because of professional or ethical reasons.

- Keep informed:

  People with low power but high interest have to be kept informed. They can't do much about it themselves but they might be able to influence key players to take action on their behalf.

- Minimal effort:

  These stakeholders have low power and low interest. Management can almost ignore these people. After all, what are they going to do if they don't like what's happening?

Chapter 4

ENVIRONMENT AND ECOSYSTEM

1. The changing environment and ecosystem

Organisations now exist in environments and ecosystems which change rapidly and they must change and adjust if they are to survive. The drivers for change in a digital world can be summarised as:

Institutional and systemic	Social
- Globalisation - Geopolitics - Regulation	- Demography
Market	**Technology**
- Consumer empowerment	- Digital technology - Automation

We will deal with the detailed drivers in the following sections.

2. PESTEL

Now we are going to look at the environmental influences in organisations. We are first going to look at the macro-environmental influences, then influences specific to a particular market, and finally, influences specific to a particular organisation within that market.

- Political
- Economic
- Social
- Technological
- Ecological:
- Legal.

In the exam you will almost certainly not be asked to explain PESTEL. Rather you will be expected to apply it to specific organisations.

Examples of PESTEL factors:

- Political: elections and changes of government, war, European Union expansion. Politics can be looked at on local, national and geopolitical (international) bases.
- Economic: interest rates, tax rates, exchange rates, economic boom or recession. It is worth mentioning the phenomenon of globalisation here. Many industries are now dominated by relatively few, global competitors.
- Social: nowadays the main social trend arises from changes in populations ie a demographic effect.. In most western countries the birth rate has fallen and there is an increasing proportion of elderly people. This can affect recruitment but it can also affect the economies of companies that they have to support a larger number of retirees. It can of course affect the marketing of products. Products suited to older people may become more popular while those suited to younger people may become less popular.
- Technological: technological changes often come out of the blue, but once they are invented there is really no turning back. Think how the internet has profoundly affected the fortunes of organisations like travel agents. Think how banks have responded by closing branches and encouraging their clients to do more and more banking online.
- Ecological: carbon emission restrictions/taxes, more stringent laws governing air and water solution, concern about the possible effects of global warming.
- Legal: health and safety legislation, equality legislation, regulation of industries.

3. Industry convergence

A couple of contemporary environmental influences should be mentioned. The first is industry convergence. Here industries which had historically been separate for some reason come together so that more diverse others products or services are now offered by the same supplier. Examples can be airlines which now offer car hire, hotels, and insurance.

Technology can form a big part in the convergence of industries. For example in a telecommunications industry whose considerable convergence between landline, mobiles, voice over internet telephone providers and television and film companies. There is increasing convergences of products which provide mobile phone access, WiFi access, music, photographs, diaries (think of the Apple iPhone which will do all of these things. You can also see convergence in complementary products. If a company makes digital camera it might also be worthwhile for it to offer printers and computers. The pressure to converge, can be driven by consumers, who may want to go to only one source for a variety of products, or it could be driven by production and convergence of the products and technology which can lead to cost benefits.

4. The international dimension

The second contemporary influence to be aware of is the international dimension. More and more organisations have global presence. Products and services are converging so that the same products can be found in many countries. This gives the producers great cost advantages, not only in purchasing raw materials but also to cover the research and development and marketing costs.

International companies can also manufacture their products where it is cheapest to do so. Note that when a company enjoys sales on a global basis it is also usually facing competition on a global basis, and many weaker companies find it difficult to compete in that fierce environment.

Because many of the global businesses are very large and significant, governments can also take an interest in their activities. In particular, valuable grants can be offered to companies to encourage them to open manufacturing plants in certain countries. Additionally, governments may sometime protect their home industries against the foreign competition.

Note that an awareness of emerging markets can be crucial to an organisation's future. There are, of course, risks that the market will 'not emerge' as fully as hoped, but organisations should be wary about missing the great opportunities that can arise from these markets.

5. LoNGPEST

This adds another dimension to the PEST model by analysing the levels at which environmental influences occur:

- Local
- National
- Global

So, for example, when analysing the importance of an environmental influence such as 'social' an organisation has to assess whether social changes are limited to local areas, a single country or are of international importance.

6. Government influences

Government is often a powerful and interested stakeholder in PESTEL its influence can be felt particularly in the political, economic and legal environments. Government policies and decisions can affect organisations in the following ways:

- Environmental protection
- The level of public expenditure
- Incentive schemes (eg to set up businesses in certain areas)
- Exchange rates
- Interest rates
- Tax rates
- Consumer and employee protection legislation
- Legislation on restrictive practices (eg industries protecting themselves)
- Monopolies and merger legislation.

Michael Porter has identified seven ways in which a government can affect the structure of an industry:

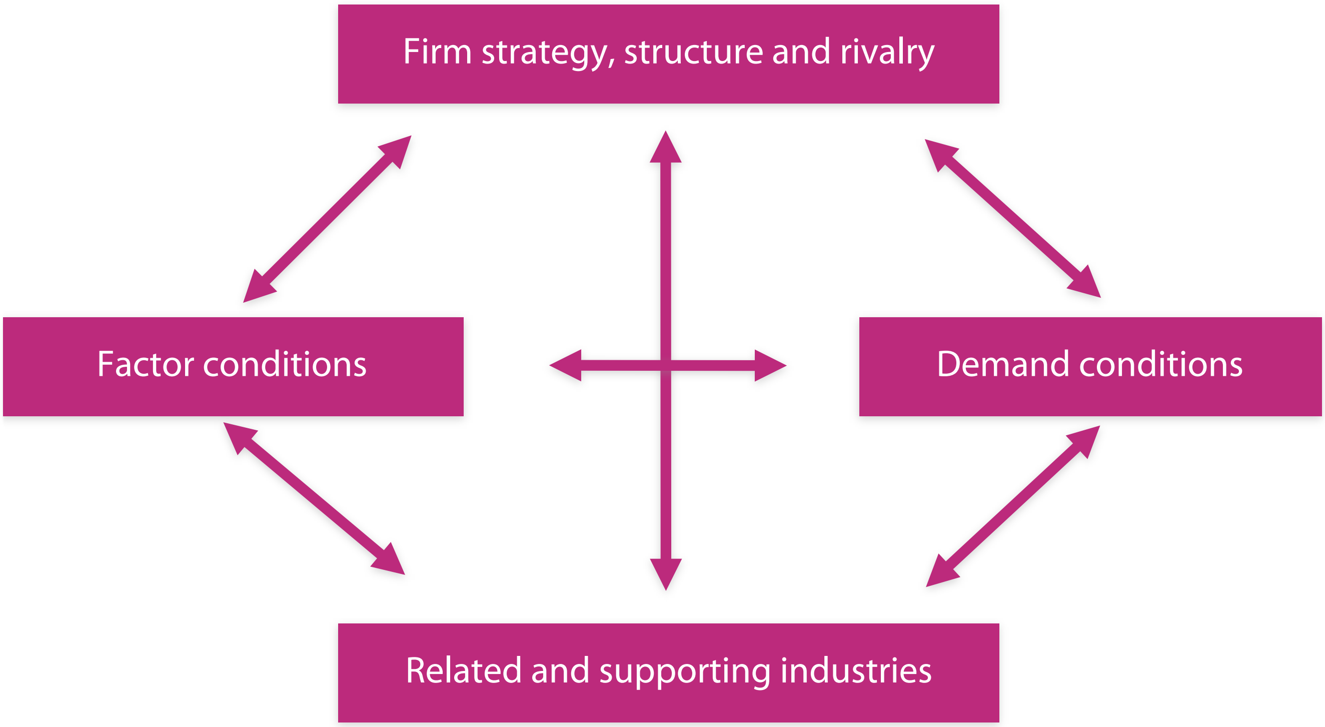
- Capacity expansion eg encouraging new businesses
- Demand eg more government spending can increase demand
- Divestment and exit from industries. For example, some governments make it very difficult for industries to close down part of their operations.
- Control of emerging industries. For example, providing support and protection in the early years.
- Entry barriers to products (quotas and tariffs)
- Competition policy. This can, for example, intervene in take-overs and mergers
- New product adoption eg how easily approval is given.

7. Porter's diamond – the competitive performance of nations

Still dealing with the international dimension, it is clear that many countries enjoy reputations for certain products and services. For example:

- Germany is associated with good car making.
- Japan is strong with respect to micro-electronics and cameras.
- France is strong with respect to wine.
- The UK (at least until recently!) was associated with a strong financial services industry.

Michael Porter began to wonder how countries can achieve such international reputations and he concluded that there were four influences.


Firm strategy, structure and rivalry
Factor conditions
Demand conditions
Related and supporting industries

Factor conditions: Some countries enjoy natural advantages. For example, France starts with an advantage in the wine industry because of its climate and soil. Finland, however, is never likely to be good at producing wine. Germany has an abundance of iron ore, ready to be used in the car and other industries. Climate and natural resources are known as basic factors. In addition, countries can develop advanced factors such as their transport infrastructure, telecommunications, and educational system. Germany, for example, has a strong tradition in engineering training and education and this gives their car industry great assistance.

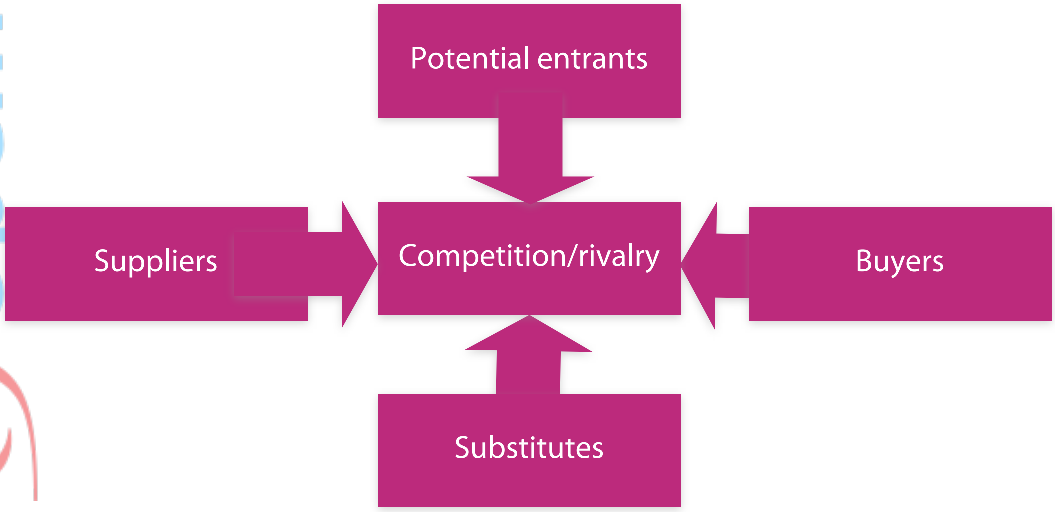
Demand conditions: The first step in developing a global presence is to start at home and the impetus to do this is known as (home) demand conditions. So, it is argued that Germany produces good cars because initially the German people demanded good solid engineering. The UK had been a major trading and manufacturing nation until the mid-1900s and this led to the development of skilled financial services and law firms to support international commerce.

Firms' strategy, structure and rivalry. Concentrate on rivalry: having a monopoly in the home market is unlikely to give you a major world presence. To be world beating you have to be really good at home and this home excellence will allow you to complete against the best of the world. Germany is perhaps really good in making cars because it has within that country Volkswagen, Mercedes, BMW and Porsche, all of are good companies competing with one another, and this allows them to become world-class.

Related and supporting industries. Successful industries often enjoy the benefits arising from a cluster of related and supporting industries. For example in the West Coast of America there are software firms, hardware firms and research institutes. Employees move around from one firm to another and a whole centre of expertise is developed. Similarly, in Scotland in the Scotch whisky industry, farmers can provide the grain, peat suppliers provide peat to give the spirit flavour. There are factories which produce or recondition the barrels, and there are large, efficient bottling plants. Not only do these related and supporting industries from efficient clusters of industries, but also they can work together so that the products become differentiated and uniquely good.

8. Porter's five forces

You will also have studies this for E2.Porter's five forces model that is used to analyse industry attractiveness. Industry attractiveness refers to how easy a business will find it to make reasonable profits. By 'reasonable profits, we mean profits large enough to compensate investors for their risks and also to make enough money to reinvest to keep the company successful. We should be looking for sustainable, long-term success.



- Rivalry:

  Competition, or rivalry, can range from:

  - Perfect competition, where sellers have no choice as to the selling price that is charged - they have to charge the market price.

  to

  - Monopoly, where sellers have much more choice about what price to charge. Changes in price will normally alter demand, revenue and profits. But remember, just because you have a monopoly doesn't mean you will make profits. You might be the monopoly supplier of something nobody wants.

  On the whole the nearer an industry gets to a monopoly the easier time its participants will have.

- Buyer pressure.

  If buyers are very powerful then they can exert pressure on prices, quality and delivery times. Selling almost all output to a few powerful buyers will be an uncomfortable situation. The more buyers you have, and the harder it is for them to switch between different suppliers the better. Businesses should try to build in switching costs, that is real costs or impediments that mean that buyers will prefer to stay with existing suppliers. We look at customer analysis in more detail in Chapter 6.

- Supplier pressure.

  Similarly, when you are buying goods from suppliers, if you have to buy a special component from a monopoly supplier you will be in an uncomfortable position. That supplier can raise prices almost arbitrarily and you have to pay what they ask. We look at supply chain management in the next chapter.

- New/potential entrants.

  Potential entrants are sitting on the edge of the industry and may be attracted in if they can see that good profits can be made. New entrants are a nuisance because they will normally try to enter with a ‘splash’: special introductory offers and big promotions. Existing companies have to respond to defend their market share against newcomers. Anything which keeps out potential entrants is known as a barrier to entry.

- Substitute products

  These usually arise by the advance of technology. Often the appearance of substitutes will surprise a business and take it off guard. For example, landline telephone companies thought that they were almost in a monopoly position because of the huge cost of entry to the market: digging up roads and laying landlines into our houses, apartments, and businesses would have been a considerable barrier to entry. However, then mobile telephones (cell phone technology) was invented and good telephone coverage could be achieved with much less expense. There is not much a business can do here. Once technology is invented it can’t really be suppressed. Most old industries have to join the new industries to maintain their market share. So now, many conventional telephone companies also have mobile phone networks in an attempt to retain their overall market share in telecommunications.

Chapter 5

COMPETITOR ANALYSIS

1. Introduction

One of Porter's five forces is competition (or rivalry), and competitors have a profound effect on any organisations' success. Competitors will affect:

- The prices that can be charged. As said above, in a perfect market all suppliers are locked to the market price.
- The market share and sales volumes that can be expected. The more competitors the more thinly spread is the market and this will limit profits.
- The cost base to which the company must aspire if it is to earn good profits. A competitor with a low cost base, particularly a cost leader, will be able to earn sufficient profits even when charging lower prices. This puts other suppliers under pressure.
- The technology that can or must be used. For example, smart-phone technology (iPhones and Android phones) led to the demise of Nokia which for too long was committed to older technology.
- Innovation and new product launches. New product launches and innovation by competitors provide them with marketing opportunities which might have to be marched.
- The conventions used in the business. For example, if an airline suddenly stopped charging for checked baggage, how would other airlines have to respond?
- Special offers and other publicity campaigns. Almost all retail organisations have to have sales early in the New Year.
- How your own initiatives will be countered ie retaliation. A price cut will usually provoke retaliation so that competitors will also cut prices. All that might happen is that everyone's revenue decreases.

Competitor analysis is defined as the:

'Identification and quantification of the relative strengths and weaknesses (compared with competitors or potential competitors), which could be of significance in the development of a successful competitive strategy.'

Competitor analysis involves understanding and analysing businesses which compete directly or indirectly with your business in at least one market, product category or service.

CIMA Official Terminology Guide 2005

Competitor analysis should:

- Identify the firm's competitive advantage or disadvantage relative to its competitors.
- Provide information about competitors' strategies – past, present and future
- Assist in developing future competitive strategies to establish advantages over your competitors.
- Assist in developing strategies which can reduce your vulnerability to competitor action.

In summary it should identify strengths and weaknesses of competitors, and the opportunities and threats for your business.

2. Who are your competitors?

Kotler (1997) identifies four types of competitor:

- Brand competitors:

  Organisations which offer similar products to the same customers and which have a similar size and structure. Examples include:

  - British Airways and Lufthansa (but not Ryanair).
  - Ford Motor Company and General Motors, but not Rolls Royce.
  - Unilever and Proctor & Gamble, but not Body Shop.
- Industry competitors:

  Suppliers who produce similar goods but who are not necessarily the same size or structure. They may compete in a more limited area or product range. Examples include:

  - All car manufacturers.
  - All airlines.
- Form competitors:

  Competitors who compete for the same needs, although they are technically quite different. Examples include:

  - Motor cars, motorbikes and public transport.
  - Netflix and national TV.
- Generic competitors:

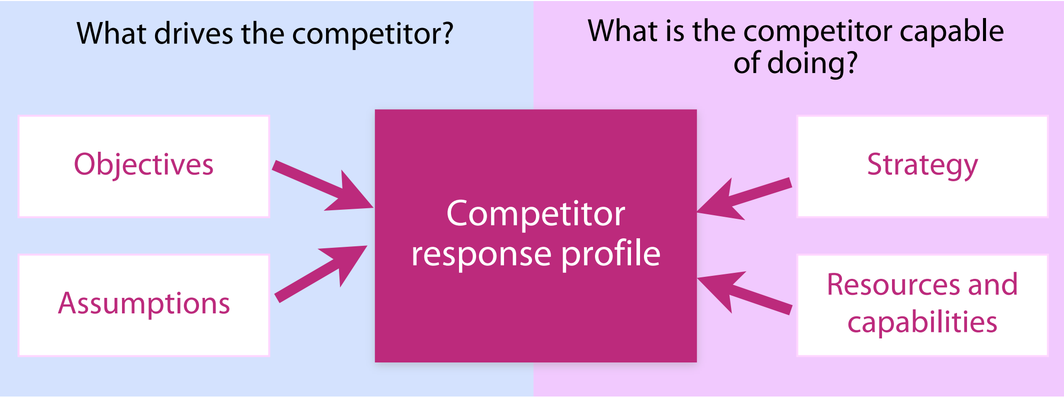
  Competitors who compete for the same income. Examples include:

  - Attending a football matches or going to a restaurant.
  - A new car or a new kitchen.

All categories provide competition, but it is likely that the most serious and cut-throat will be between brand competitors. So BMW and Mercedes will monitor each other carefully, but neither will keep Suzuki under such close scrutiny. Just observing current brand competitors is not enough however, as other competitors or technologies can emerge. Therefore, Shell and BP are brand competitors but both need to keep watch on form competitors such as battery manufacturers who whose technology is of increasing application for short car journeys.

3. Practicalities of competitor analysis

Porter suggests the following approach to determining the information needed for an adequate response to a competitor:


What drives the competitor?
What is the competitor capable of doing?
Objectives
Assumptions
Competitor response profile
Strategy
Resources and capabilities

So, a competitor is driven by:

- Its objectives, such as market share, growth rate, share price.
- Its assumptions, such as its beliefs in industry trends ie how the market and technology will develop, and its experience with a product has been.

What a competitor is capable of doing depends on:

- Its current strategy, such as current product range, pricing and its market positioning. It has presumably proved that it is competent here.
- Its current and future capabilities; its weaknesses

The 4Cs can be a useful way of remembering the processes needed to complete competitor analysis:

- **Collecting** the information. To do this is essential to think about what information is needed and to plan for its collection. The random collection of information is pointless.
- **Converting** information into intelligence. This can be broken down into CIA:
  - Collate the information ie store and catalogue it in ways in which it can be retrieved and used
  - Integrate various elements of information
  - Analyse and interpret the information
- **Communicating** the intelligence to the people who need it such as the board of directors, marketing staff and sales staff
- **Countering** any adverse competitor actions, i.e. using the intelligence.

Information about competitors can be obtained from a wide range of sources, some internal and some external. For example:

- Sales representatives deal frequently with customers and may hear about competitors' offers and products.
- The Research & Development Department could identify new patents filed by competitors which might give some warning about future developments.
- The purchasing may find out that a supplier is now also supplying a competitor.
- The financial statements will give information about competitor profitability and financial strength.
- Trade association information will provide information about market size, from which competitor market shares can be deduced.
- Trade exhibitions allow examination of competitors' products.
- Competitors' web-sites can show product specifications and prices.
- Newspaper articles might feature competitors.

A vast quantity and variety of data can be collected in this way and it must be indexed, collated and stored in ways that make it accessible to users. Databases can provide a very useful way of holding diverse data. The data also has to be scrutinised for inaccuracies.

Often reports will be produced on each major competitor and these should be distributed to the relevant decision-makers in the company. It is important that information is updated and communicated regularly.

Finally, the objective of this process is to use the data to counter threats and to make use of opportunities. For example, if it becomes clear that a competitor's new product has hit development problems and its launch will be delayed, this might be an opportunity to bring forward the launch of your own product so as to obtain the lead position.

Chapter 6

INTERNAL ANALYSIS

1. Introduction

Assessing the strategic position of an organisation involves not only assessing the external environment (as has been done in the previous chapter) but also assessing the internal resources and competences of the organisation.

Organisations where external and internal factors match have a much greater chance of success than when there are mismatches.

This chapter covers:

- Resources and competences
- Product life cycle

Porter's value chain can also give important insights into the internal workings of an organisation but this is covered in Chapter 6 along with supply chains

2. Resources and competences

2.1. Introduction

When analysing an organisation's position we have to analysis its strategic capability. This is an internal quality of the organisation, and capability depends on:

- Resources (things you have like manufacturing resources, patents, people), and
- Competences (how you use the things you have).

Strategic capability (that is capability which gives sustained competitive advantage so that you do better than others in the long-term) depends on:

- Threshold capabilities, which are the minimum capabilities needed for the organisation to exist at all so that the company just survives; and then on.
- Additional capabilities, which give the organisation competitive advantage.

The additional capabilities can arise from:

- Unique resources, or
- Core competences.

Unique resources are resources which one organisation has but which others don't.

It could, for example, be the right to use a particular technique or patent. However, unique resources are usually hard to find. Many resources, such as production equipment, can be bought easily and this allows rivals to copy what is being achieved.

Core competences are ways in which an organisation uses its resources better than its competitors do and in ways that other organisations cannot easily imitate or obtain. Core competences are generally harder to identify and define, and they are therefore more difficult for other organisations to copy. Core competences will therefore usually provide a more permanent way in which an organisation can achieve and retain competitive advantage. For example, Apple has core competences in designing and developing new hardware and services such as iTunes. Other companies find Apple's competences difficult to replicate.

2.2. Position-based or resource-based strategies

To a large extent, traditional strategic planning has been position-based. In this approach a strategist focuses on the environment (for example using PESTEL analysis or Porter's five forces), discovers and analyses what's happening in the environment, and then reacts to that, often changing what the organisation is doing.

A more recent approach (Prahalad and Hamel) is resource-based strategy. This maintains that a strategist should focus on resources and competences. Successful combinations of resources and competences, particularly unique resources and core competences, take years to develop and can be hard for others to copy. These resources and competences are the secret of the organisation's success: they are likely to be the organisation's 'crown jewels'.

A position-based strategic planning approach can lure organisations into areas where they haven't got the appropriate resources and competences, and it makes them abandon the resources and competence which hitherto have made them successful. Why should they throw away the resources and competences in the hope of discovering others? There is no reason to think that an organisation which has been successful in one area of business through employing specific resources and competences should automatically expect to be successful in another area where entirely different resources and competences are required.

Organisations, therefore, should perhaps not abandon their resources and competences too easily. The organisation should view the future as not just something it happens to them and which renders its resources and competences irrelevant. Perhaps they can create and mould the future to make use of their resources and competences. Of course as in so many matters dealing with strategic planning, a balance is needed. There is no point in an organisation clinging to existing resources and competences when technology or public taste has advanced, and their older products and services have become unpopular. However, it is very salutary for organisations to remind themselves where their strengths lie, and not to give those up without a reasonable struggle.

3. Typical resources

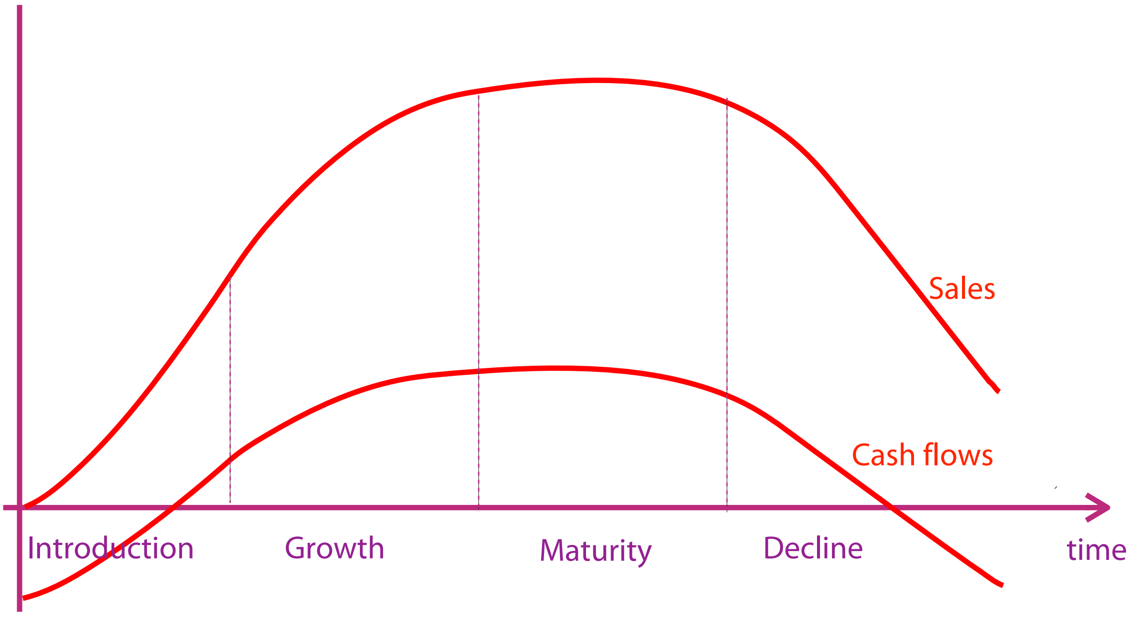
Many resources can be remembered by the 'M words':

- Money
- Men and women (human resources)
- Manufacturing/machinery Material
- Methods (knowhow)
- Management
- Management information systems (IT)
- Marque/make (brand)
- Markets
- Marketing
- Material

4. Product life cycle

Again you will have met this in Paper E2 and it is described here again to refresh your memory. It can be important to recognise the stage products are in their life cycle to ensure that the company's revenue is secure. Many pharmaceutical companies face sharp fall-off in revenue when a valuable drug loses its patent protection. Some companies have been in danger of several of their income streams ending almost simultaneously - a so-called patent cliff.

The diagram which purports to show how the sales revenue and net cash flows of a product change as it moves from the introductory phase through growth to maturity and then decline.



Although this diagram is very well known the real problem is that no product is guaranteed to follow this pattern and even if it does the lengths of the various phases on the diagram will show tremendous variation. For example, the mature phase of some products can last for decades, but for others may last only a few years. What we would really like to know for strategic planning purposes is when irrevocable decline sets in. This diagram doesn't predict that. What it does do is provide us with a set of labels which can be used as a kind of shorthand. Therefore:

- **Introductory phase.**

  If we know that a product is in the introductory phase we know that we should want to watch sales very carefully to see whether the product is likely to succeed or not. If sales are poor emergency action is needed to try to rescue the new product. Marketing spend will be high and profits low.

- **Growth phase.**

  Here, many competitors will start coming into the market, encouraged by our success. We might therefore want to keep advertising the product strongly so that we can stay ahead of the field.

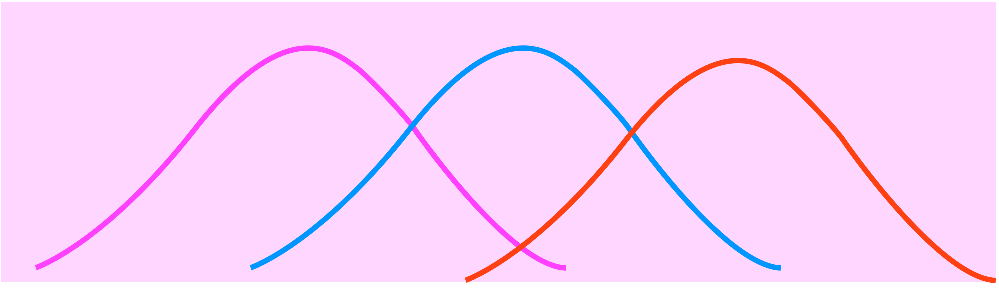
- **Mature phase.**

  At the mature phase there are likely to be many suppliers, and buyers of this established product are likely to be well-informed and demanding. The market is not growing, so the only way to improve market share is by stealing from competitors. Generally at this phase there is price pressure and buyers demand more for their money as they are more aware of the different features of the product. In extreme cases, there may be over- capacity in the industry and this will cause very extreme price pressure indeed.

- **Decline phase.**

  Businesses must be careful not to misinterpret a temporary dip in the sales as the start of the decline phase. Relatively cheap upgrades and facelifts can extend product life for a few years and that is important because usually development costs will have been already covered, as will depreciation of machinery bought for the production of that product. The additional years can be very profitable despite the product being in decline. Decline phases can last for very long times for some businesses and plenty of money can still be made there. A strategic decision has to be made about whether to get out of the product quickly or whether to be the last player remaining standing, effectively becoming a monopoly player in a declining market

  Ideally the company would arrange to have a series of products progressing through the life cycle as follows:



A pattern like this can result in relatively stable revenue, but it can be difficult to achieve such a neat pattern in practice because:

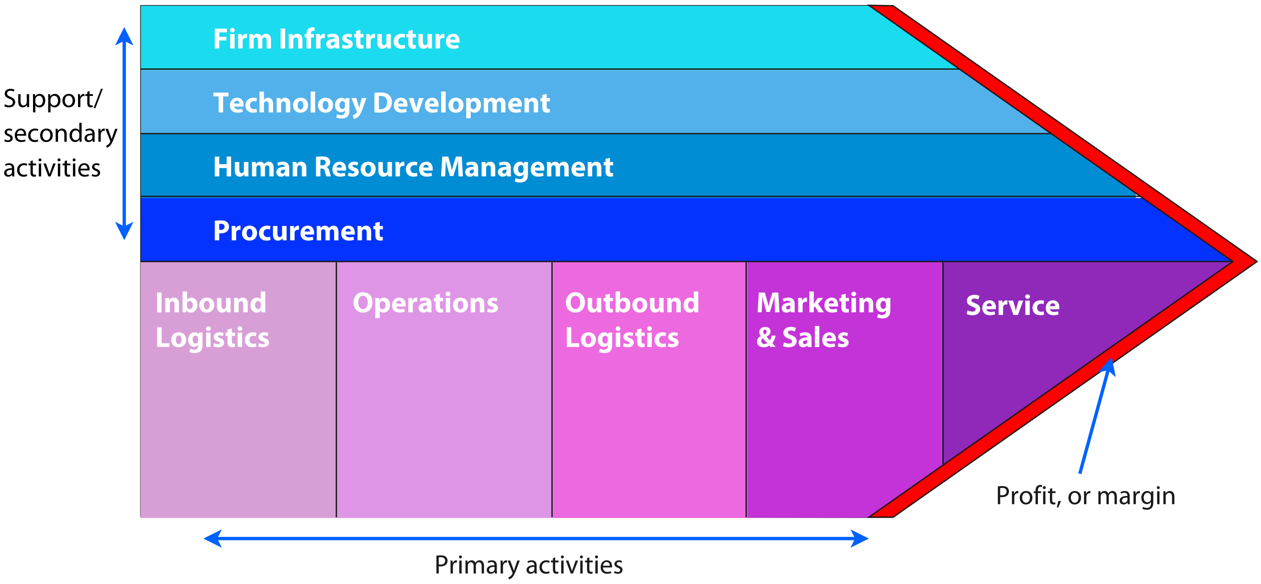
- There are often delays in the development and launch of new products.
- The decline of a product can be sooner and more rapid than expected.

Chapter 7

VALUE CHAINS AND VALUE NETWORKS

1. The value chain and value networks

Porter's value chain displays groupings of all the activities that organisations carry out. The activities are divided into primary activities and secondary activities. All activities have costs and successful businesses organise and carry out their activities in such a way that value is added. It is the value added that allows revenues to exceed costs so that profits are made.



To add value, the organisation must be doing more for its customers than simply carrying out the 'face value' of the activities, otherwise customers would presumably carry out the activities themselves. Customers either cannot carry out the activities at all, or cannot match costs, or don't want to carry on the activities and so are willing to pay others to carry them out instead. For example:

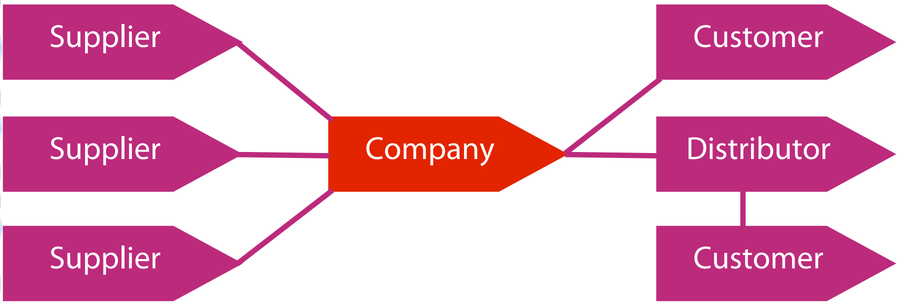
- knowhow – suppliers often use knowhow that customers simply don't have
- economies of scale – suppliers often produce efficiently in huge volumes with each customer buying only a small proportion. Suppliers' economies of scale simply cannot be replicated by each customer
- risk – suppliers might shoulder production risks that customers don't want
- location – suppliers might be in a low-cost area while customers are in a high cost area
- flexibility – suppliers are variable costs, while doing it yourself usually entails more fixed costs.

As always, success in business arises from one of Porter's generic strategies –cost leadership or differentiation – each with or without focus.

The value chain is also used to emphasise linkages between activities. For example, how would spending more on human resources through better training, reduce the cost of after sales service because of product breakdowns? How would moving the head office out of the (expensive) capital city affect sales and marketing and, perhaps, outbound logistics?

Although originally formulated for manufacturing industries, value chains can also be applied to service industries. Although the importance of some elements, such as inbound logistics, will reduce, the importance of other elements, such as human resources, can increase because employees in service industries are usually more customer facing and can have a great effect on the service being sold

Curiously, the value chain relegates procurement (the purchase of goods and non-current assets) to a support activity, yet has sales and marketing in primary activities. In modern manufacturing companies this disparity does not make much sense because what is important is the complete chain from suppliers to customers. This is recognised in the idea of value networks:



Value networks recognise that few companies stand alone and that what is ultimately supplied to and paid for by customers depends on activities carried on by many suppliers, distributors and, indeed, logistical companies. Ultimately, customer satisfaction and value added depend on all parties working well together.

2. The supply chain and supply chain management

Manufacturing organisations ultimately make profits by buying raw materials, processing them then selling them to customers and the arrangement of these elements is a vital part of the value chain and form the supply chain.

Supply chain management has the following features:

- Integrating and managing the sourcing, flow and control of materials.
- Supply chain management covers the flow of materials suppliers through to customers
- Potentially many suppliers and customers.
- Synchronising of materials received, processed and despatched to customers.
- Simultaneously achieving good levels of customer service and low costs for the company.

Supply chains are often divided into upstream and downstream operations in an analogy with material floating down a river, into and then out of our operations:

- Upstream – the flow of materials into the organisation.
- Downstream – the flow of materials from the organisation to the customers.

However, these terms might sometimes have to be interpreted liberally as materials can go directly from supplier to customer with the organisation itself acting as a co-ordinator of the flow.

For businesses that manufacture their own products, the upstream supply chain will be taken to consist of the following value chain activities:

- Procurement – purchasing inputs such as supplies, material and equipment.
- Inbound logistics – receiving raw materials, holding inventory and issuing to manufacturing operations as required.

Downstream supply chain will be assumed to consist of:

- Outbound logistics – the storing and distribution of finished goods.
- Marketing and sales – identifying customer needs and generating sales.
- Services - after sale service and supplies.

It will be obvious that IT now forms a major part of supply chain management. For example orders are received from customers and from that component lists and work schedules are automatically generated. Orders are automatically sent to suppliers also. This can enable a range of products with different specifications to be made efficiently for customers. No longer do businesses to set up long production runs of identical items to keep costs down and profits up.

Supply chains can be:

- Push systems: products are made for inventory and then ‘pushed’ to the market.
- Pull systems: customers’ orders trigger the purchase of raw material and the production of units. The units are ‘pulled’ through production by customer orders.

Chapter 8

SWOT, OBJECTIVES, CRITICAL SUCCESS FACTORS AND BENCHMARKING

1. SWOT/TOWS analysis

At the end of the internal and external environmental appraisals, organisations should be able to carry out a SWOT analysis which summarises:

Internal	Strengths Weaknesses
External	Opportunities Threats

For example, the company might have a very good IT system (a strong resource) but be poor on marketing (a weakness in a resource). The economy might be set to boom (an environmental opportunity), but a powerful competitor could be planning to enter the market (an environmental threat).

It can be useful to arrange these into a TOWS matrix:

	Strengths	**Weaknesses**
Opportunities	Look for opportunities that make use of strengths	Look for strategies which address weaknesses
Threats	Look for strategies which use strengths to overcome/avoid threats	Defensive: Look for strategies which avoid threats and minimise effect of weaknesses

Certain things match well. For example, if there is an opportunity which is matched by a strength then the organisation should try to make use of that strength. However if the opportunity depended on using an area in which the company was weak, then the chances of success there are relatively low. Either avoid that opportunity or look for strategies which address the weakness.

Similarly, if there is a particular threat which is matched by a strength then it should be relatively easy for the company to overcome that threat. But if there is a threat in an area where the company is particularly weak, then the company could be in some difficulty. For example the threat might be coming from overseas imports which are particularly low cost. If our organisation is weak in manufacturing so that its costs are relatively high because of inefficient machinery it's not easy to see what the company can do to fight that threat and it will be particularly vulnerable in that area.

Perhaps what it should do instead of fighting the imports face on is to try to avoid the whole conflict by, for example, moving up market. Note, however, that if it is going to move up market it must be strong in the areas of research, development, quality, and innovation.

2. Goals and objectives

2.1. Introduction

Once the company's strategic position has been assessed, it is then possible to set **objectives.**

Missions can be very grand and not very specific. It's all very well for a company to say that it has 'quality' as one of its mission, but what does quality mean? What frequency and type of defect must be eliminated and which will be tolerated? By when must a quality level be attained? Something more specific is needed - and these more specific ambitions are objectives.

2.2. SMART objectives

'Good' objectives should be SMART:

- Specific: sales, rejects, cost per unit are all specific. Better and improve are not.
- Measurable: usually that the specific aspects of performance have to be quantified.
- Agreed/accepted/achievable: imposing an unrealistic or impossible target will be ineffective.
- Relevant: relevant to the person responsible (ie they can affect it); relevant to the organisation's mission. If objectives are seen as irrelevant, arbitrary and merely an exercise in management power they will fall into disrepute.
- Time-bound: objectives should be attained within a specified time frame.

An example of 'real-life' objectives is printed below:

Financial objectives over the next 3 years:

- To increase the operating profit before taxes by 15%
- Return on equity of at least 20% Cost-income ratio below 45%
- Net credit losses below 0.5%.

3. Difficulties with objectives

3.1. Consistency of objectives

You can think of objectives as first being set at the top of the company, at its corporate level, and then flowing down through various divisions, departments and, perhaps, to individuals. It's important to ensure is that the various objectives are consistent with each other. However, the following are worth noting:

- More than one objective is needed. Once objectives are set that's what people concentrate on. They know they are going to be judged on whether they meet those objectives, and other desirable elements of behaviour are often then ignored.
- In organisations there are interdependencies. The performance of one person depends on many others. It can become difficult to later decide who was responsible for achieving an objective - or more dramatically, who was responsible for not achieving that objective.
- Short-term/long-term conflicts. Many businesses are critically judged by investors and commentators on each year's profits. Their profit targets are often published in advance Accounting isn't really very good at dealing with the long-term as most accounts are simply made up for 12 months. There can be a great temptation therefore, to make short term savings like cutting expenditure on research and development, training and maintenance. These measures will boost current profits but this will certainly cause difficulties in a few years' time .
- Not all desirable attributes are easy to measure. However, remember that if the attribute is desirable then objectives must be set for them otherwise that particular behaviour will be ignored.

4. Critical success factors and KPIs

An organisation can easily end up with many objectives and there is a danger that the more easily attained objectives is what people concentrate on. However, there are some objectives which are more important or fundamental to success than others. These are the organisation's critical success factors.

Here are two definitions:

- Johnson, Scholes & Whittington: 'Those product features that are particularly valued by a group of customers, and, therefore, where the organisation must excel to outperform the competition'

Or:

- Where an organisation must perform well if it is to succeed.

The second definition is simpler, but the first is more useful because is places emphasis on the idea that success is caused by customers: it is vital (critical) to meet customers' expectations.

Examples of critical factors could be:

- Profitability
- Market position
- Reputation
- Market share
- Productivity
- Product leadership
- Personnel development
- Employee attitudes
- Public responsibility

Key performance indicators are what's measured in relation to critical success factors. With some CSFs it is easy to see what the KPI would be (for example if CSF = profitability then KPI = profit). For other CSFs proxies have to be constructed and used (for example if CSF = reputation, then KPIs = results of customer surveys, repeat business, customer loyalty etc)

Exactly what determines a critical success factor depend on factors such as:

- Structure of the industry. For example, in an industry with only a few large companies, maintaining market share will be very important to prevent being overwhelmed by competitors.
- Competitive strategy. If the competitive strategy is based on low cost, efficient production then keeping the cost per unit produced low will be critical.
- Geographical location. For example, if operating in a developing country, market penetration might be more important than profit so that later, if the economy develops, the company is well-placed.
- Environmental factors. If technology is changing, the critical success factor vital to survival is to exploit the new technology at least as well as competitors.

Classification of CSFs and their associated KPIs:

- Internal eg inventory control; delivery times
- External eg exchange rates Monitoring eg actual vs budget Building eg targets to launch new products or updates.

Also, they can be classified as:

- Monitoring. Critical success factors needed to maintain current success eg actual costs vs budgeted costs
- Building. For example, targets to launch new products or updates

- Qualities of good KPIs
- Ownership. A person or team must feel that they have ownership of a KPI for which they will be held responsible. For example, the KPI owners must be able to influence the achievement of the KPI and there should be a relationship between effort and whether the KPI is met.
- Fairness. When assessing performance it is important to do so fairly. So, if the factory went on strike for six months, there is little advantage in shouting at the sales department about missed sales targets
- Achievable. If a KPI is regarded as being unachievable no matter what effort is expended, many employees will become disillusioned and demotivated. KPIs should be stretching but achievable.

Johnson and Scholes suggested a six step process for developing CSFs:

- Identify the success factors that are critical for profitability.
- Identify what is necessary (the 'critical competencies') to achieve a superior performance in the critical success factors.
- Develop the level of critical competence so that a competitive advantage is obtained.
- Identify appropriate key performance indicators for each critical competence.
- Give emphasis to developing critical competencies which competitors will find it difficult to match.
- Monitor the firm's and competitors' achievement.

For example:

An airline might identify that a critical success factor is to obtain the maximum flying hours possible from each aircraft

- One of the critical success factors is to have fast turnaround times
- Concentrate on achieving that. Eg, have no pockets on the back of seats so that removing rubbish is not needed; allow one item of hand luggage per passenger so that passengers can board and eave planes more quickly; have internally stores steps so that passengers do not have to wait for ground-crew.
- External eg exchange rates, total market size
- Aircraft have to be ordered and fitted out with their own steps.
- Keep competitors' performance under review to try to make sure that at they do not beat you

5. Benchmarking

5.1. Introduction

Benchmarking can be defined as:

'The establishment, *by the collection of data*, of comparators that allow relative levels of performance to be identified.'

Benchmarking can be thought of as a scientific way of setting objectives and targets. The sources of data that can be used include internal data (for example, comparing the results of different branches), data about other companies (for example, those in the same industry) and government data (for example, data about employee sick days).

Without benchmarking, there is the risk that objectives are either much too easy or much too difficult to achieve. Either of these errors will damage performance.

5.2. Types of benchmark

There are a number of different ways in which benchmarks can be established. A common categorisation of the approaches is as follows:

- **Internal benchmarking.**

  Internal benchmarking does not mean simply inventing an objective out of thin air because benchmarking implies comparison. Internal benchmarks are likely to be set benchmarks by looking at historical performance or performances achieved by different branches. If last period's actual results showed that it took 12 minutes to produce each unit, then it might be valid to set a benchmark of 11.5 minutes for the next period. Similarly, if the best branch achieved a net profit percentage of 15% then that might be a valid target to set all branches.

  The potential danger with these approaches is that they are both inward-looking and no attention has been paid to what other organisations, such as competitors are achieving. Additionally, the opportunities for learning are small. If an organisation does not realise that competitors are better, not only is that dangerous in itself, but the organisation will never be inspired to try to find out how competitors do better.

- **Industry benchmarking.**

  In this approach, benchmarks are set by looking at what other organisation in the same industry achieve. Industry benchmarking can be divided into:

  (1) Non-competitor benchmarking.

  (2) Competitor benchmarking

  Example of non-competitor benchmarking can be seen in comparing treatment results for hospitals in different towns, the efficiency rubbish collection by different local authorities and the examination success of children in different schools.

  Examples of competitor benchmarking can be seen in aircraft turnaround times (as examined above) for different airlines and the load factor (what percentage of seats are occupied). Both of these are relatively easy to measure because they are very visible and you can be sure that airlines keep a close watch on their competitors' statistics. However, you will appreciate that many of the most interesting pieces of data about a competitor will not be easily accessible and that competitors will often try to keep this information confidential.

- **Best-in-class benchmarking.**

  In this approach, rather than comparing entire organisations, the individual activities of an organisation are compared to those activities in other organisations where the activities are carried out really well. So, it would be valid for a telephone bank to compare its call answering times to those in an organisation that had a good reputation in dealing promptly with phone calls. A hotel business might learn a lot from studying how airlines change their fares in response to demand. Both hotel room vacancies and unoccupied aircraft seats are perishable commodities and maximising profits in both industries depends on enticing in the last guest or traveller at the maximum marginal revenue.

  The great strength of this approach is the high degree of learning that is encouraged. The observation of very successful processes and activities, wherever found, will often generate radical innovation and improvement in an organisation's competitive strength. Furthermore, very good performance in one aspect of a certain industry (perhaps a very slick web-site in a travel site) is likely to raise customers' expectations in many different industries, so that, for example, slick websites are expected everywhere.

5.3. Potential problems with benchmarking

(1) As explained above, the benchmark there is always the danger that a benchmark might not be appropriate. Even if set correctly initially, there is a risk that is it not updated so that organisations become complacent and aim at the wrong things.

(2) Benchmarking does not itself explain why an organisation might not be performing properly. The whole exercise is rather pointless if efforts are not made to understand the causes of an organisation's shortcomings. Instead of using benchmarking for a push towards improvement, and finding out how good companies achieve high performance, managers can sometimes become defensive and begin to defend their performance by attacking the credibility of the target.

(3) Whatever you measure you change. Employees know that whenever performance targets or objectives are set then almost certainly appraisal will follow. Therefore full attention is paid to whatever is measured often to the detriment of overall desirable performance.

Chapter 9

CUSTOMER RELATIONSHIP MANAGEMENT AND CUSTOMER ANALYSIS

1. Customer relationship management (CRM)

5.4. 1.1. Introduction

Customers provide organisations with their only source of revenue, hence profits. It is, therefore, important that the businesses carefully manage their relationships with customers and that customers' requirements are understood and nurtured.

It is important to gather information about potential and existing customers that enables:

- Customer acquisition
- Customer retention
- Customer extension

These terms are explained below and it is worth considering how much IT can contribute to these activities.

5.5. 1.2. Customer acquisition

Methods that can be used:

- Promotion (eg advertising)
- Incentives (eg incentives to sales personnel to sign up new customers)
- Services (eg provision of e-services that are of value to customers)
- Profiles (eg understanding potential customers and what they require)
- Customer service (eg good customer service)
- Direct e-mail

5.6. 1.3. Customer retention

Methods that can be used:

- Extranets (eg allowing customers to see what inventory you have)
- Personalisation (eg making recommendations about other items that might interest you)
- Community (eg involving customers in user forums)
- Promotions (eg special offers going exclusively to existing customers)
- Loyalty schemes (eg points per $ of purchases).

5.7. 1.4. Extension

This refers to widening the range of products that are purchased by customers.

Methods that can be used:

- Direct e-mail
- Learning from customers about what their interests and requirements are
- On-site promotion (eg special offers that promote impulse buys that persuade customers to try something new)

2. Customer profitability analysis

Many costs are driven by customers and a customer profitability analysis approach may be appropriate.

CPA is an application of Activity Based Costing techniques to customers.

Traditionally, ABC is applied to products but in a modern business environment in which it is vital that organisations respond promptly to the demands of customers, analysis of customers can provide vital management information.

The approach is exactly the same as the ‘normal’ activity based approach, except that we attempt to identify the profitability of each type of customer.

We can then identify unprofitable types of customer and attempt to persuade them to alter their buying behaviour so they become profitable customers.

This approach also identifies where we should focus our cost reduction efforts.

Example:

Vilnius Ltd manufactures components for the heavy goods vehicle industry.

The following annual information regarding three of its key customers is available.

$	*X*	*Y*	*Z*
Gross margin	897,000	1,070,000	1,056,000
Orders placed	200	320	700
Sales visits	80	100	140
Invoices raised	200	320	700

The company uses an activity based costing system and the analysis of customer-related costs is as follows.

Sales visits	$420 per visit
Order processing	$190 per order placed
Despatch costs	$350 per order placed
Billing and collections	$97 per invoice raised

Using customer profitability analysis, how would the customers be ranked?

Solution:

	X	*Y*	*Z*
Gross margin	897,000	1,070,000	1,056,000
Less: customer specific costs:			
Sales visits (80/100/140 x $420	33,600	42,000	58,800
Order processing (200/320/700 x $350	70,000	112,000	245,000
Billing and collections (200/320/700 x $97	19,400	31,040	67,900
Profit	**736,000**	**824,160**	**551,300**
Ranking	**2**	**1**	**3**

3. Customer profitability statement

There is no set format for the statement, but it would normally be similar to the one below.

	$'000	$'000
Revenue at list prices		100
Less: discounts given		8
Net revenue		92
Less: cost of goods sold		50
Gross margin		42
Less: customer specific costs	28	
financing costs:		
credit period	3	
customer specific inventory	2	
		33
Net margin from customer		9

Example:

Frodo Ltd supplies shoes to Sam Ltd and Gollum Ltd. Each pair of shoes has a list price of $50 and costs Frodo Ltd $25. As Gollum buys in bulk it receives a 10% trade discount for every order for 100 pairs of shoes or more. Sam receives a 15% discount irrespective of order size, because that company collects the shoes, thereby saving Frodo Ltd any distribution costs. The cost of administering each order is $50 and the distribution cost is $1,000 per order. Sam makes 10 orders in the year, totalling 420 pairs of shoes, and Gollum places 5 orders of 100 pairs each.

Which customer is the more profitable for Frodo Ltd?

Solution:

It can be shown that Frodo Ltd earns more from more from supplying Sam, despite the larger discount percentage.

$	Gollum	Sam
Revenue	25,000	21,000
Less: discount	2,500	3,150
Net revenue	22,500	17,850
Less: cost of shoes	(12,500)	(10,500)
Customer transport costs	(5,000)	-
Customer administration cost	(250)	(500)
Net gain	4,750	6,850
Number of pairs of shoes sold	500	420
Net gain per pair of shoes sold	**$9.50**	**$16.31**

4. Customer portfolio analysis

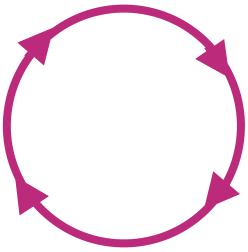
Customer portfolio analysis is a marketing concept used to analyse supplier-customer relationships to help managers allocate scarce organisational resources and ensure long-term profitability of customer relationships. It is an analysis of current and potential customers to help decide which customers a firm wants to serve in the future.

There is no uniform approach, but most companies would want to know, at the very least, that value of sales made to the customer and the profit earned on those sales. As suggested in the definition above, the emphasis is on using the analysis to increase future profits by ensuring key customers are retained and worthwhile potential customers are targeted systematically and transformed into actual customers.

Typical evaluation criteria of customers include:

- Type of the customer relationship—a partnership, recurring (client) or occasional.
- Customer service needs—products, services, consultancy etc
- Customer’s decision criteria when selecting suppliers—price of purchase, time to delivery, ease of purchase, quality of the products, reliability etc.
- Our share of the customer’s purchases for specific products—small, medium, large
- Revenue generated from customer
- Customer profitability - high, moderate, low – both in absolute and in GP% terms
- Potential for additional sales- high, moderate, low, none
- Relationship with customer - easy, average, challenging
- Customer’s own business prospects -failing, stabile, growing
- Customer’s apparent business strategy
- Credit risk

The analysis cycle can be shown as:



1 Understand the current portfolio

- What is the current mix?
- What do they buy?
- What sales do they generate?
- What is the potential of the current portfolio of customers?

2 Define the ideal portfolio

- What do we offer that has sustainable value?
- What balance of customers: size, industry, products bought does this imply?
- What business model: number of products, low cost, high quality, delivery time?

3 Build the strategy

- Define the customers and products
- Focus on the chosen customers and their requirements

4 Execute

- Allocate resources
- Measure performance
- Review progress and targets

For example, consider an airline such as British Airways or Lufthansa:

Current portfolio:

‘Top’ business travellers: buy business class tickets; very profitable; likely to grow in the current economic environment (say).

‘Ordinary business travellers: economy seating; moderately profitable as seats often booked or changed at short notice. Aspire to upgrading to premier economy or business class

Leisure travellers: book well in advance and look for cheap deals. Not particularly profitable unless planes >80% full.

Currently, 25% of revenue from business travellers, 75% from leisure travellers.

Ideal portfolio

Cut price no frills market saturated. We can offer full service flights-meals, checked-in luggage, entertainment to the business sector to differentiate ourselves. This is potentially the most profitable sector of the market.

Our ideal mix of passenger is 50% revenue from business travellers, 50% from leisure travellers.

Build the strategy

Focus on making ourselves more attractive to business travellers. Carry out surveys to see what they value most: inflight WiFi, lie flat seats, seat space, gourmet food, fast immigration clearance.

Execute

Refurbish planes where necessary, develop meals, devise advertising campaigns, foster continuous feedback so that we can see if our targeting is successful.

5. Customer empowerment

Undoubtedly IT, in particular the Internet, has altered the balance of power between sellers and customers so that, nowadays, customers have much more power and influence. Of course, customers can abuse their power such as when a diner threatens to heavily criticise a restaurant unless the bill is heavily reduced or a customer orders many items of clothing fully knowing that only one will be bought and that the others can be returned at the supplier's expense.

Examples of customer empowerment include:

- Social media: Twitter, Instagram and Facebook etc allow customers to comment on and rank their customer experiences. Perceived missteps by a company can quickly gather a storm of protest from the Twittersphere. Sites such as Tripadvisor and Airbnb encourage comments and rankings.
- E-commerce: sites like Amazon allow consumers to comment not only on the performance of the retailer they buy from but also on the products they have bought.
- Price transparency: instead of having to visit several suppliers to find the best deal, internet sites can be quickly explored. Indeed there are internet sites which specialise in comparing other sites' prices.
- Easy switching: many industries have had to offer easy and automated switching from one supplier to another. For example, gas and electricity suppliers in the UK.
- Ebay and fintech: retailers and banks can be abandoned as consumers sell directly to each other (Ebay) or lenders supply cash directly to borrowers (as seen in some peer-to-peer lending sites).
- Consumer polls: some companies conduct internet polls to allow customers to vote on what features they would like on new products.
- Advert popularity: brands conduct surveys to assess which adverts consumers like.
- Buy and return: if products are bought over the internet the seller really has to guarantee that the product can be returned without quibble.

6. Hyperpersonalisation

Many web-sites personalise their visitors' experiences: greeting you by your first name, allowing you to track orders, easily reorder the same product again and so on. Amazon uses prompts like:

'You might also like.....'

'People who bought that also bought....'

Hyperpersonalisation takes the process a stage further. For example:

- After browsing a website, but not buying, sending you an email about similar products you might want to buy.
- Building up a record of responses to offers. For example, if your purchasing history shows you tend to go for upgrades in hotel rooms when offered, make sure that you are offered an upgrade. If you show a preference for a particular brand, then perhaps offer a bulk-buy opportunity.
- If you never buy meat-based products from a supermarket site, then it might be presumed that you are vegetarian and your experience of the web-site will be adapted to that assumption.
- If you suddenly start buying babies' nappies (diapers) then emailing you in 6 months with baby food offers and in about a year emailing with baby shoe offers.

Of course, sometimes they get it wrong. I use Booking.com a lot for booking accommodation. Let's say I stay in city X for one night. I then tend to get a series of emails telling me that prices have come down in city X. Some cities I have to visit frequently, but many are once-off visits and I have no reason to go back. A more intelligent use of big data should be able to differentiate between the two types of visit.

Chapter 10

STRATEGY FORMULATION

1. An overview

Sustainable competitive advantage means doing better than your competitors in the long-term. That means profits must be sufficiently high and safe to provide the proper rewards for investors and to allow the company to invest in research and development and marketing so that they can at least defend their prime position in the long term. Usually they will seek to strengthen their lead over competitors.

There are two stages in a determining strategy for sustainable competitive advantage:

(1) **Choose a generic strategy**. This is like a fundamental strategy and there are three:

- cost leadership
- differentiation, and
- focus.

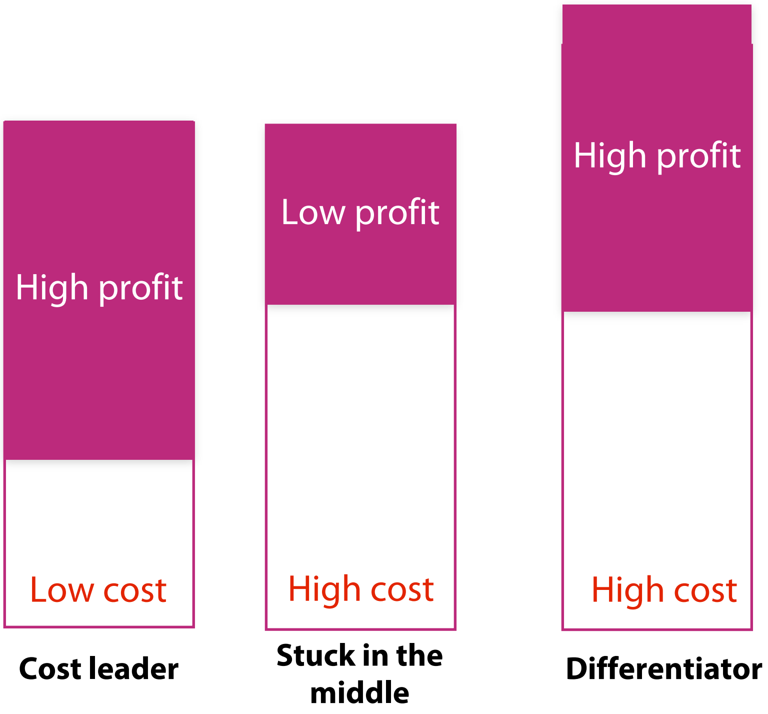
Generic strategies are associates with the theories of Michael Porter, described below.

(2) **Choose strategic direction**. Having decided the fundamental way in which the organisation is going to compete it then must turn to more detailed matters. The organisation can expand by:

- market penetration, efficiency gains, consolidation and withdrawal
- market development
- product development, and
- diversification.

These options will be shown on Ansoff's matrix

2. Porter's generic strategies



Porter sets out three generic strategies:

- Cost leadership
- Differentiation
- Focus

The first two are set out above and are usually mutually exclusive. Focus is discussed later and can be applied on top of either differentiation or cost leadership.

A generic strategy is required if a company is to gain **competitive advantage**, meaning that it is capable of earning **good profits in the long term**. 'Good profits' are profits which recompense investors adequately for risk whilst allowing the company to invest in research and development, training and new machinery to stay ahead of competitors.

2.1. Cost leadership

Here a company is supplying a basic product or service into a competitive market. It can't put its prices up because the product is ordinary and there are competitors supplying equivalent products. If the selling price can't be raised, the only way the company can improve its margins is to lower its costs.

A cost leader aims to have the lowest costs of all its competitors and its competitors are liable to be **'stuck in the middle'**, squeezed between low prices and high costs, so making miserable profits. The cost leader will be much stronger financially and will have spare cash to spend on marketing, development of new products and the purchase of new machinery. It could even drop its selling prices temporarily to put extra pressure on competitors. Weaker competitors could be forced out of the market, reducing competitor pressure and making the cost leader even stronger.

Cost leaders need to have ferocious cost controls: their only trick is keeping costs low and that is therefore where they must pay great attention. The whole culture of the organisation will be focused on cost control.

An excellent example of a very successful cost leader is the Irish airline company, Ryanair. This company is enormously profitable. The ways it uses to keep costs down include: non-reclining seats (cheaper, lighter, nothing to break down), no seat pockets (nothing to clean out after each flight), use of cheap airports, modern efficient aircraft, web-based communications with customers.

Cost leaders are not guaranteed a secure future. They are, for example, vulnerable to technological breakthrough which might allow a competitor to become even cheaper.

2.2. Differentiation

Differentiators do not aim to compete by supplying ordinary products or services. They compete by supplying better products and services for which they can charge more. Here 'better' means something which better suits a customer so that the customer doesn't mind paying more. The product could be differentiated by quality, design, features, size, reliability, brand etc.

So, the differentiator company increases its margin by raising its prices. It is not so concerned with lowering its costs – in fact, its costs might be higher because of better quality products with more features.

Here, the company is much more interested in innovation and higher customer service than saving costs. Costs, of course, are important but the differentiators' trick is the ability to raise selling prices.

An excellent example of a differentiator company is Apple. This company is an excellent innovator and its products always have very high design values. Customers are willing to pay more for an Apple computer than they would for a Windows-based PCs of similar performance because of the qualities that Apple machines have.

2.3. Focus

The focus company has decided to concentrate on a small sector of the market rather than trying to address the whole market. The company might have decided to do this because it is relatively small and doesn't have the resources to target the whole market, or it might have decided to target particularly profitable segments or segments where it feels it has particular expertise.

Once a company has decided to focus it still has to decide whether to be a cost leader or a differentiator. It must be said, however, that a natural combination of generic strategies is to become a focus-differentiator because if you are concentrating one or two market segments which you have got to know very well, it is probably natural that you develop products and services which are particularly attractive to those segments and for which more can be charged.

Porter's generic strategies is a very useful model: if a business is successful, it will be following one of these strategies. If it is not successful, then it should be advised to follow one of these strategies!

Note that it is usually easier for very large companies to become cost leaders than for small companies. This is because large companies can enjoy greater economies of scale and if they are international they can make goods in countries with cheaper labour. It is very difficult for a small company to drive down its costs as much and it would usually be bad advice to tell a small company to compete on cost/price. Small companies can find a niche which might allow them to survive. If they focus on a small segment of the market and differentiate their products to appeal to consumers in that market, they can make good profits even with higher costs. Also, the segment they are specialising in might be too small to interest larger players, who are usually after large mass markets and large scale production.

3. Ansoff's matrix and gap analysis

After the generic or fundamental strategies have been decided on, we can turn to more detailed strategies. Ansoff's matrix is an immensely useful way of presenting the options that companies have. It can be helpful if you think that most companies wanted to increase profits and Ansoff's matrix sets out all the ways in which this could be done.

	Existing products	**New products**
Existing market	Withdrawal Consolidation Penetration Efficiency gains	Product development
New markets	Market development	Diversification • Related • Unrelated

In the top left quadrant the company will stay with present products and present markets. If it does that it can increase profits by:

- Efficiency gains (which is a euphemistic way of talking about cost savings).
- Withdraw from some markets allowing it to concentrate on other markets or just allowing it to save money.
- Consolidate its existing markets. For example make its back office operations more efficient or it could merge with a competitor.
- Try to gain the market share, (increase market penetration). So the company might try to raise its market share from, say, 20% to 22%.

All of these options are regarded as relatively low risk and low return. The company is in its home territory both for products and markets.

Next, the company can turn either to product development or market development.

An example of market development will be trying to export.

An example of product development might be a washing machine manufacturer now trying to make vacuum cleaners.

Both of these options offer considerable potential increases in returns but they also offer higher risks. They tend to require an amount of upfront investment, and there is no guarantee that that investment will be successful. The company is venturing into unknown territories either geographically or in its product mix.

The final option, and by far the most risky, is diversification. Diversification can be:

- related for example a sister industry, or
- unrelated, sometimes known as conglomerate diversification.

By and large, there is very little justification for unrelated diversification as it is difficult to generate synergy (where two businesses together produce more profits than the total of their profits from operating separately). However, related diversification may be create some benefits, for example, by integrating supply and purchase operations and in cross marketing to each other's customers.

Diversification is covered more fully in the following chapter.

Remember this diagram summarises everything a company can do to try to increase its profits.

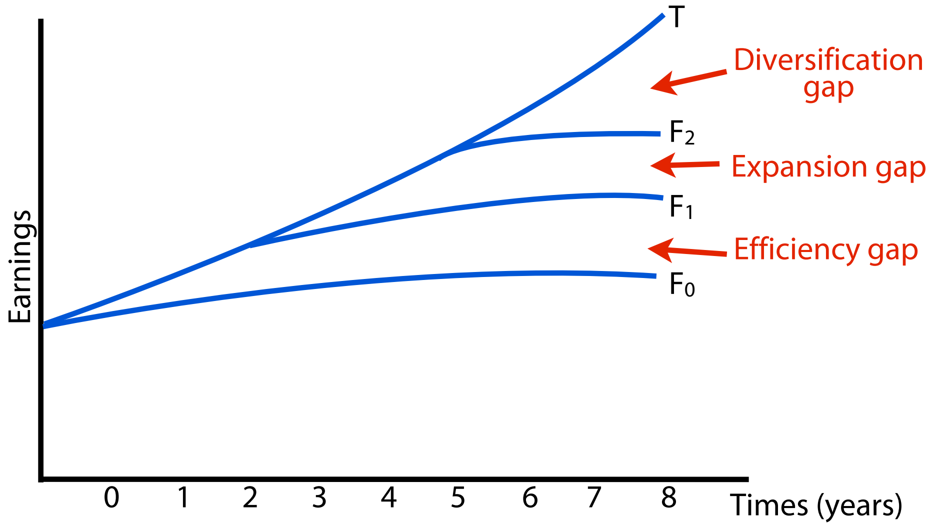
Ansoff's matrix is often coupled with gap analysis. This compares what an organisation is likely to do it is continues more or less as it is doing, and what its owners (or other stakeholders) want to organisation to achieve.

T = target

F_0 = initial forecast

F_1 = forecast adjusted for improvement in internal efficiency

F_2 = forecast adjusted for product market expansion



Ansoff's product-market matrix sets out how the gap might be closed:

- Withdrawal, consolidation, penetration, efficiency gains (efficiency gap)
- New markets (expansion gap)
- New products (expansion gap)
- Diversification (diversification gap)

4. Strategy Evaluation

Towards of the end of the strategic planning process an organisation may have identified a number of strategies, any of which might hold the possibility of achieving the organisation's objectives. It is important to realise that it is unlikely that there is one strategy which is obviously better than all the others. One strategy might hold the possibility of higher profits but may carry with it additional risk. So how do we choose between those strategies and decide on which strategy or indeed which mix of strategies to follow?

One of the most useful ways to evaluate both future strategies and to appraise past strategies strategic options is to use the Johnson and Scholes method of **suitability, acceptability, and feasibility.**

- **Suitability.**

  Under suitability, the organisation will look at whether the strategy plays to its strengths or whether it makes use of weaknesses. Does the strategy make use of environmental opportunities? Does it guard against threats? Is it suitable in relation to the way environmental factors and competition are changing?

- **Acceptability.**

  This raises the question of 'acceptable to whom?' Ultimately, this is asking if the strategy is acceptable to the stakeholders, but we already know that stakeholders, in general, do not all want the same thing. There is little point following a strategy which is entirely unacceptable to customers. There is probably little point in following a strategy which is liable to provoke wide scale industrial unrest. There is little point adopting a strategy which its shareholders don't want, for example, a strategy which markedly increases the risk of the investment. Here of course, management has to make a compromise, but at the end of the day it has to adopt the strategy which most stakeholders are prepared to tolerate.

- **Feasibility.**

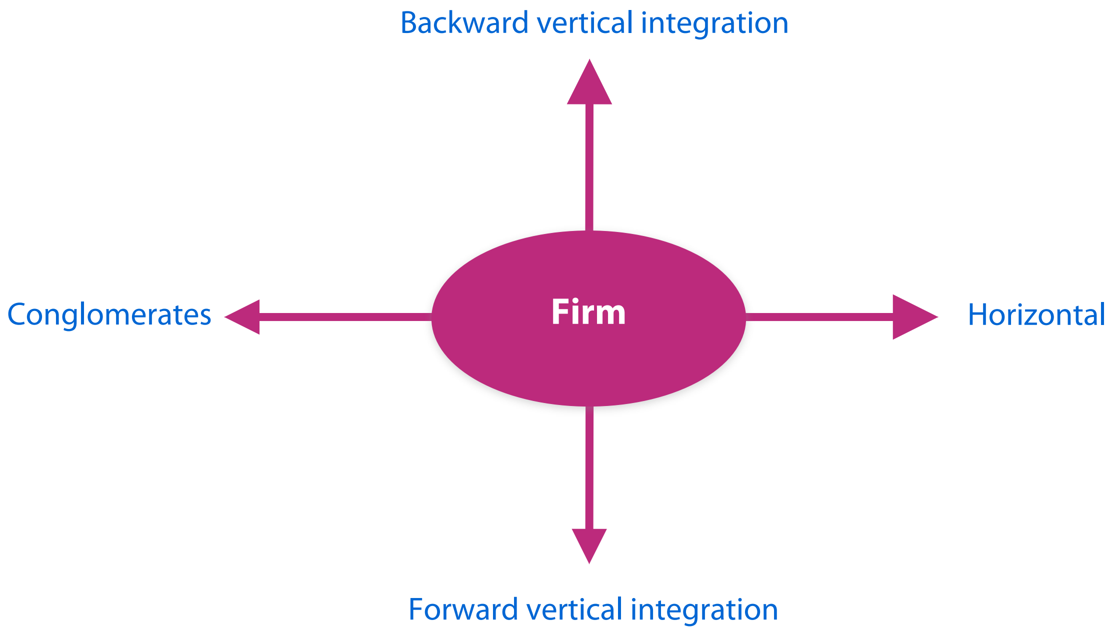
  This looks primarily at the resources of the organisation. Do we have the money, the marketing, the management, the manufacturing and the materials available? If we don't have these important resources available and can't make them available, the strategy is simply not feasible; we can't do it and therefore it would need to be ruled out.

Chapter 11

DIVERSIFICATION AND PORTFOLIO MANAGEMENT

1. Types of diversification

One quadrant of Ansoff's matrix showed expansion by diversification. This diagram shows four types of diversification:



We will deal with them in two sections, starting with conglomerate diversification.

2. Conglomerate diversification

Conglomerate diversification is unrelated diversification: the businesses which are combined have no connection whatsoever. An example would be a supermarket joining with a car manufacturing company. What advantages might arise from this? Well, the directors of the operations are likely to say that the combined companies will probably give the shareholders a more stable pattern of returns. Diversification often smooths the pattern of returns and profits. However this overlooks the fact that if the shareholders had wanted a stake in both the supermarket and the car manufacturer they could buy shares in those separate companies themselves. They don't need the companies to combine for the investors to enjoy a portfolio effect.

The directors might then claim that there will be cost savings or synergy. However, if the businesses are truly different it's difficult to see how the cost savings or other forms of synergy could arise. Suppliers, processes, and customers will be entirely different. It will be difficult to achieve economies of scale in manufacturing or processing. There will be few opportunities, if any, for cross-marketing. It's unlikely that even the head offices can be combined. If a business which is already well-run is taken over by another one, the only way in which the value of the business can increase is if more profits are squeezed out of it. With conglomerate diversification, it is difficult or impossible to achieve this. The only situation in which conglomerate diversification might add value is if the company taken over is badly run and its new owners can put in better management, turn the company around, and probably sell it on for an increased price, yielding the shareholders a

3. Horizontal diversification; backward and forward vertical integration

Horizontal diversification means expanding into a related business. For example, an airline taking over a chain of hotels. Because the businesses are related there is a real chance that the combined business will achieve efficiencies, for example, through cost savings or better marketing. You can see how the airline and the hotels could cooperate by offering accommodation when people go to the airline booking system.

Backward and forward of vertical integration are forms of related diversification. Backward vertical integration means taking over or setting up with a supplier. Forward vertical integration means taking over or setting up a distributor or customer. Obviously, the operations are related and there appear to be great attractions in vertical integration. It's very easy for a firm to say it itself, I make a profit, my suppliers also make a profit and I want their profit and therefore we will take them over. However, like many elements of strategy the real situation can be more complicated. For example, does the acquirer company have the skills to manage the company that has been bought? Is the company being locked into using one supplier of outlet?

4. Portfolio management: the Boston Consulting Group matrix

The Boston Consulting Group Matrix is a very well-known analysis tool for analysing a portfolio of products or a portfolio of subsidiaries/divisions.

The axes of the matrix are:

- Market or industry growth
- Relative market share which is the company's market share/largest market share

Relative market share

Market growth rate	Low	High
Low	Dog	Cash cow
High	Question mark/problem child	Star

We'll go through each quadrant in turn.

- Question mark/problem child. This product has a high growth rate but a low market share. Why is it known as a question mark or problem child? Well, the BCG analysis suggests that there is no long-term future for this product if it has only a small market share. Suppliers who have large market shares have much greater economies of scale and could easily dominate the small supplier. The question therefore is: should we get out of this product or should we try to grab a large market share? If we go for the large market share, this will require investment. It will be a heavily negative cash flow because money has to be spent on promotion, research and development or investing the margin (that is reducing the selling price to win a higher market share).
- Star products. If the quest by the problem child for high market share is successful, the product will become a star. This isn't as good as it sounds. Although we now have a high market share (and therefore would enjoy economies of scale and are well down the experience curve), because we have one of the highest market shares, and highest profiles, competitors will be trying to steal market share from us. We will be the target for competitors also wanting to gain a high market share. Remember, if the market has a high growth rate this product is perceived as a product with a future and many companies will be eager to get a large share of the action. Therefore, cash flow with the star product is usually soon to be roughly zero.
- Cash cows. The initially high growth rate of products will always slow down, perhaps to zero or even becoming negative (a declining market). The product then becomes a cash cow. It's a cash cow because we still have a high market share but nearly all the initial expenses will have been written off. Also because this is now perceived as an old product, competitors will not be keen in stealing market share from us. Essentially they leave us alone. We therefore enjoy high cash inflows without having to spend a lot on promotion, or research and development, or defending our market share.
- The dog sector is on its own. Cash cow products do not turn into dogs! This is a product which has a low growth rate and we don't have much of a market share. Therefore, get out of it: divest. There's no point spending time effort and money achieving a high market share in an old product. So, close down the production facilities or try to sell them to another company.

There are considerable flaws in the BCG analysis. For example:

- It puts high emphasis on the importance of a high market share, but there are many companies with only small market shares which are successful in the long-term. For example, the Porsche car company has a small market share when compared to Ford, General Motors and Toyota. Yet, it is one of the most profitable car companies per car sold in the world. Really, you have to define very carefully what your market is. That can be room for relatively small specialist suppliers who can continue to make good profits year in, year out.
- The second problem is to do with how the BCG is interpreted. If a product went from just being a star product to just being a cash cow product because of a slight change in market growth rate, to suddenly cutback massively on promotion, research and development, and defending the product. The interpretation must not be too black and white. If market growth rate goes from 10.1 to 9.9, with 10 being the division between star and cash cow, in reality not a lot has changed and the change in treatment of the produce should not be abrupt.
- Third, relative market share and market growth rate are probably inadequate measures. By relative market share we really mean competitive strength, but there's much more to competitive strength than just our market share. For example our brand name, or where our production facilities are located can give us very high competitive strength. Similarly, instead of just having a market growth rate what we really mean is market attractiveness. Attractiveness depends on factors such as risks and the amount of competition which is present in that market. We might prefer to go for a product which has a relatively low growth rate, but which is relatively low risks.

These criticisms do not mean that BCG is useless but, like any model, care needs to be exercised in interpreting the results. No model guarantees the truth.

Finally let's return to the name portfolio analysis. If we have many problem children they will all require financing and where is that money going to come from? If we have almost exclusively cash cows we have a very positive cash flow now, but a few years down the line the market for those cash cows could have declined rapidly and what are we going to replace those cash flows with?

A well-balanced portfolio has some cash cows and some question marks. The cash generated from the cash cows can be used to invest in the question marks, so securing the long-term future of the company.

5. Methods of growth

- **Purchase of subsidiaries and mergers**

  This the simply buying 100% or a controlling interest in a supplier, distributor, competitor or unrelated company. Cash has to be paid or shares issued to the owners of the acquired business and this can have implications for funding this method of expansion.

- **Joint ventures.**

  In joint ventures, two companies will normally establish a third company, contributing cash assets, know-how, and personnel. Joint ventures are extremely good ways of dealing with large projects where high amounts of capital are required, where there is high risk, and where a mix of skills is essential. Joint ventures can spread the burden of providing finance and bearing the risk, and by choosing your joint venture partners carefully, you can accumulate an appropriate mix of skills. It's important at the outset that all the parties to the joint ventures know exactly what is expected of them, how profits are to be shared, and how exit from the joint venture is to be managed.

- **Licensing**

  Under licensing arrangements, one company gives another the right to use a process or a trade name. For example, it's very common for brewing companies where a company in Belgium licenses a brewery in, for example the UK to make beer.

  For the licensor (that's a company granting the license), this is a relatively low risk way of growth. They earn the money primarily from royalties and don't have to undertake any great risk in setting up production and distribution facilities overseas.

- **Franchising**

  A franchise can be regarded as a more involved type of licensing agreement. Many retail and fast food organisations operate through franchises. Typically, the franchisee (that's the person who wants to start the business) buys a franchise from the franchisor. In return the franchisor provides advice and the right to use a process and trade name. The franchisor might also provide raw materials. Certainly the franchisor will impose very strict rules so that the operation to which they give their name trades in such a way that the organisation is not damaged. The franchisee manages the day-to-day operations of the franchise, buying raw materials from the franchisor and selling them. Often a royalty is paid back to the franchisor based on profit or turnover.

- **Strategic alliance**

  A strategic alliance can be very useful where a more formal merger or takeover is not allowed or is not thought to be wise. An example of strategic alliances is the co-operation which is undertaken by many airlines. They form an alliance, such as 'Star Alliance' and this allows their passengers to make use of different airlines and different airlines' lounges, reasonably seamlessly, and to collect and use their air miles in a common scheme. Such alliances are allowed in airlines where the takeover of one airline by another is often resisted on monopolistic or nationalistic grounds.

- **Strategic networks**

A network is an organisation's set of relationships with other organisations. The relationships can be:

- Vertical: such as with suppliers and customers
- Horizontal: such as with competitors.

The term encompasses:

- Strategic alliances
- Joint ventures
- Long-term supplier/buyer relationships
- Relationships with research and development consultancies
- Relationships with logistics companies

The implication is that goods and services flow freely within a strategic network as required. For example, a product might be designed or tested by a consultancy which makes recommendations to the various component manufacturers, which communicate with one another to coordinate production and which then communicate with logistics companies to ensure the components come to gather as needed at the final assembly company, from where logistics companies will look after distribution to buyers.

Each separate organisation in the network has its own set of skills, but by acting together they can create capabilities (and therefore profits) which were not possible when acting in isolation without a network structure.

Above all, co-ordination is key and IT will play a very important role in ensuring that this occurs accurately, efficiently and quickly. Information needs to be shared either by giving members of the strategic network access to a shared database, probably held in the cloud or by permitting access through extranets to each organisation's data.

Chapter 12

STRATEGIC PERFORMANCE MEASUREMENT

1. Introduction

It is often said that ‘whatever you measure you change’. The corollary of that is presumably ‘whatever you don’t measure you won’t change’. Employee performance and behaviour need to change continually, both to improve current activities and also to direct employees towards new activities and behaviours. If that is to happen then employees’ performance needs to be measured and feedback and incentives provided to encourage satisfactory outcomes.

2. Performance

This can be defined as:

> “A task or operation seen in terms of how successfully it is performed”
> (www.Oxforddictionaries.com).

Organisations differ greatly in which aspects of their behaviour and results constitute good performance. For example their aim could be to make profits, to increase share price, to cure patients in a hospital, or to clear household rubbish.

The primary required tasks are often found in the organisation’s mission statement as it is there that the organisation’s purpose should be defined. The term ‘primary required tasks’ is used because, although the primary task of a profit-seeking business is to make profits, this rests on subsidiary tasks such as good design, low cost per unit, quality, flexibility, successful marketing and so on. Many of these are non-financial achievements.

Some aspects of performance are ‘nice to have’ but others will be critical success factors. For example, the standard of an airline’s meals and entertainment systems will rank after punctuality, reliability and safety, all of which are likely to be critical to the airline’s success.

3. Performance indicators and key performance indicators

Performance indicators (or performance measures) methods used to assess performance. For example:

In profit-seeking organisations:

- Profit
- Earnings per share
- Return on capital employed

In not-for-profit organisations:

- Exam grades (a school)
- Waiting times for hospital admission (a health service)
- Condition of roads (a local government highways department)

Particularly in profit-seeking organisations, the prime financial performance indicators allow performance to be measured but they say little about how that performance has been achieved. So, high profits will depend on a combination of good sales volumes, adequate prices and sufficiently low costs. If high profits can only be achieved by a satisfactory combination of volume price and cost, then those factors have to be measured also and will need to be compared to standards and budgets.

Similar effects are found in not-for-profit organisations. For example, in a school, a CSF might be that pupil leaving with good standards of literacy. But that might depend on pupil-teacher ratios, pupils' attendance and the experience of teachers. If these factors contribute to good performance, they need to be measured and monitored.

Just as critical success factors ('An area where an organisation must perform well if it is to succeed.') are more important than other aspects of performance, not all performance indicators are created equal. The performance indicators that measure the most important aspects of performance are the **key performance indicators (KPIs)**. To a large extend KPIs measure how well CSFs are achieved; other performance indicators measure how well other aspects of performance are achieved

There are a number of potential pitfalls in the design of performance indicators and measurement systems:

- Not enough performance measures are set. Often, directors and employees will be judged on the basis of performance measure results. As said above, 'Whatever you measure you change' and employees will tend to concentrate on achieving the required performance where it is measured. As also said above, the corollary is that 'Whatever you don't measure you don't change' and the danger is that employees will ignore areas of behaviour and performance which are not assessed.
- Too many performance indicators, especially where they are not ranked by importance and none have been identified as KPIs. Performance indicators have to be measured, calculated, reported to management; discrepancies must be explained or excuses invented. Too many measures can divert time from more important tasks and there is a danger that employees concentrate on the easier but more trivial measures than on the more difficult but vital targets.
- The wrong performance measures. For example, applying strict cost measures in an organisation where luxury products and services are sold (a differentiation strategy) is likely to detract from the organisation's strategic success.
- Too tight/too loose performance measures. Performance indicators that are too difficult to attain can lead to a loss of employee motivation, gaming and the misrepresentation of data. Performance measures that are too loose can pull down performance. Benchmarking can help to avoid this. Internal benchmarking generally sets measures based on previous period's measures or set measures with respect to other branches or divisions. However these internal benchmarks can lead to complacency as many organisations have to compete with others and benchmarks should be aligned to competitors' performance.

4. Performance measures – a practical framework

To establish a performance measurement system, something like the following is needed for each measure:

(1) A meaningful title of the measure

(2) What is its purpose and how does that purpose relate to strategic success?

(3) What other performance measures might be affected by this one, how are they affected and how are conflicts to be resolved?

(4) Who will be held responsible for it?

(5) What is the source data, who is responsible for its supply, how is it measured and how is the measure calculated?

(6) What investigations and explanations are required and who is responsible?

(7) What target is set and how has that target been determined?

(8) How often should the target be updated?

(9) How often is the measure reported on?

(10) Reporting and action?

For example, consider a passenger train company called TTTE:

1 Title of performance measure	Punctuality (the percentage of trains arriving at their destination on time).
2 Purpose of performance measure	TTTE's strategic objective is to provide comfortable, reliable and punctual services to passengers. TTTE competes with other train companies, cars and airlines. Punctuality is seen as a key competitive lever and therefore must be measured.
3 Other performance measures affected	Safety – safety checks and speed limits take priority. Cleanliness – it might be necessary to occasionally reduce cleaning to keep to the timetable. Energy consumption running a train faster than normal (though within speed limits) will cause higher fuel consumption. Punctuality takes precedence.
4 Who is held responsible?	Operations director.
5 Source data, measurement and calculation of the measure.	The duty manager at each station is responsible for logging the arrivals time of each train. A 5 minute margin is allowed ie a train is logged 'on time' if it is no later than 5 minutes after the advertised time. Beyond 5 minutes the actual time by which the train is late is logged. Results will be calculated in percentage bands: on time, up to 15 minutes late, >15 - 30 minutes late, >30 minutes – 1 hour late, >1 hour late.
6 Investigations and explanations	Whilst logging late arrivals, station duty managers should also note the cause where possible. The operations director must collate this information using statistical analysis which highlights persistent problems such as particular times of the day, routes or days of the week.
7 Target and how it is determined	The target is dictated by the railway timetable. The timetable should be reviewed twice a year to look for ways of reducing journey times to keep TTTE competitive with improvements in competing transport.
8 Update of target	The banding and any tolerances will be updated annually.
9 How often should the measure be reported	Weekly
10 Reporting and action	The operations director will report performance on a monthly basis to the board together with plans for service improvement.

(Adapted from: http://www.institute.nhs.uk/quality_and_service_improvement_tools/quality_and_service_improvement_tools/performance_measures_sheet.html)

Performance indicators are relevant to the following models and theories:

Mission statements: these define the important aspects of performance that sum up the purpose of the organisation.

Stakeholder analysis: recognises that different stakeholders have different views on what constitutes good performance. Sometimes what stakeholders want is different to what the mission statement suggests as the purpose of the organisation. This can be a particular problem when the stakeholders are key-players.

Generic strategies: the main generic strategies to achieve competitive advantage are cost leadership and differentiation. If a company's success depends on being a cost leader (a CSF) then it must carefully monitor all its costs to achieve the leadership position. The company will therefore many performance indicators relating to cost and efficiency. If a company that has chosen differentiation as its path to success then it must ensure that it is offering enhanced products and services and must establish measures of these.

Value chain: a value chain sets out an organisation's activities and enquires as to how the organisation can make profits: where is value added? For example, value might be added by promising fantastic quality. If so, that would be a CSF and a key performance indicator would the rate occurrence of bad units.

Boston consulting group grid: this model uses relative market share and market growth to suggest what should be done with products or subsidiaries. If a company identifies a product as a 'problem child' BCG says that the appropriate action for the company is either to divest itself of that product or to invest to grow the product towards a 'star' position on the grid. This requires money to be spent on promotion, product enhancement, especially attractive pricing and perhaps investment in new, efficient equipment. Good performance would be measured by market share growth rather than profits. Return on investment could be low until full use is made of the new equipment. Once a product reaches its 'cash cow' stage performance measures will focus on revenues, costs and profits.

PESTEL and Porter's five forces: both the macro-environment and competitive environment change continuously. Organisations have to keep these under review and react to the changes so that performance is sustained or improved. For example a laws were introduced which stated that suppliers should be paid within a maximum of 60 days, then a performance measure will be needed to encourage and monitor the attainment of this target.

Product life cycle: again, different performances are required at different stages of the life cycle. In the early days of a product's life, it is important to reach a successful growth trajectory and to stay ahead of would-be copycats. At the maturity stage, where there is great competition and the market is no longer growing, performance will depend on low costs per unit and maintaining market share to enjoy economies of scale.

Company structure: different structures inevitably affect both performance and its management. For example as businesses become larger many choose a divisionalised structure to allow specialisation in different parts of the business: manufacturing/selling, European market/Asian market/North American market, product type A/product type B. Divisional performance measures, such as return on investment and residual income, then become relevant

Information technology (IT): how could new technologies help performance and measure performance? Remember that sophisticated new technology does not guarantee better performance as costs can easily outweigh benefits. If IT is vital to a business then down-time and query response time become relevant as might a measure of system usability.

Human resource management: what type of people should be recruited, and how are they to be motivated, appraised and rewarded to maximise the chance of good organisational performance? Performance measures are needed, for example, to monitor the effectiveness of training, job performance, job satisfaction, recruitment and retention. In addition, considerable effort has to be given to considering how employees' remuneration should be linked to performance.

5. Non-financial performance indicators

5.1. Introduction

Accountants, perhaps naturally, concentrate on financial performance measures. Although it if good to see that the gross profit percentage has increased or that the return on capital employed has improved, nothing about those measures explains what has caused those improvements. Often, performance improvements arise from changes in the way in which a business is run or improvements in what it offers. The financial results then 'keep score'.

This chapter looks at one model which helps to extend performance measurement towards non-financial performance.

5.2. The balanced scorecard (Kaplan and Norton)

Perspectives	*Possible measures*
◉ Financial perspective	GP%, ROCE, share price, EPS, Gearing, Operating profit %
◉ Customer perspective	Repeat sales, new customer acquisition, sales growth, low 'churn' rate, customer surveys
◉ Internal business perspective	Cost/unit. Quality, speed of delivery, customer service, choice of product
◉ Innovation and learning perspective	New products launched, patents filed, courses attended, qualifications gained.

The balanced scorecard of Kaplan and Norton defines four perspectives, or levels, that are needed:

- Financial perspective: this is really the reward of success. Good profits, increasing share price and high return on capital employed are all ways in which organisations chart their success.
- Customer perspective: the immediate cause of financial success is a happy customer base. Repeat business, growing sales and profitable prices are generally prerequisites for good profits.
- Internal business perspective: customers are happy when an organisation does well what it purports to do. It might be making goods at a very low cost per unit; it might be making goods of almost 100% quality.
- Innovation and learning perspective: this supports and sustains all the other perspectives. An organisation might currently be the lowest cost producer, but you can be sure that competitors will be trying to steal that crown, and if the organisation fails to strive for improvement, competitors will soon overtake it. Similarly, an organisation might have the most technically advanced product, but someone, somewhere will discover a better product. No organisation can afford to stand still and it must continually learn and discover what innovations might be useful.

Performance needs to be measured across all of the perspectives. If you think your customers come back to you because of the quality of your production, it makes no sense not to measure that quality, and where necessary, to improve it.

Chapter 13

SOME FORECASTING AND PLANNING TECHNIQUES

1. The Delphi technique

It is important for managers to think about what future events (both positive and negative) may affect their organisations. Understanding these events can allow problems to be avoided or mitigated: “Forewarned is forearmed”.

Of course, what the future holds is uncertain and different people have different views but the Delphi Technique can be used to estimate the likelihood and impact of future events and to arrive at a consensus view.

The Delphi Technique is an iterative technique in which experts give their opinions, which are then summarised and fed back to the same experts who are encouraged to look critically at the outcomes and, where necessary, modify their opinions. The experts answer questionnaires in two or more rounds.

In general, the process works as follows:

- Define the problem
- Members with suitable expertise are chosen for the Delphi panel. A facilitator is also chosen who will look after the progress of the process.
- The members of the panel are kept separate and answer questionnaires and surveys. Separation is important to ensure that no member is inhibited from expressing his or her opinions, that opinions are independent and that group-think is avoided. The questionnaires can include asking members to rank items for importance or likelihood. There will often be room for open-ended comments so that other issues can be raised.
- The questionnaires and surveys are collected and the responses summarised.
- The summaries are given to the panel members (again separate) who can reconsider their original views and who will complete another questionnaire. Once again, anonymity is important as panel members will be more willing to change their views if they feel it is right to do so.
- The process is repeated until the responses have substantially converged.

2. Strengths and weaknesses of the Delphi technique

2.1. Strengths

- A rapid consensus can be achieved
- Participants do not have to meet to reach agreement
- Individuals are able to express their own opinions
- The panel can include a wide range of expertise
- Relatively low cost to administer
- Avoidance of interpersonal problems amongst the panel members
- A good chance that consensus is reached.

2.2. Weaknesses of Delphi technique:

- Does not cope well with widely differing opinions or large changes in opinions (paradigm shifts). Participants are likely to stick to their original views in the face of radical alternatives.
- The desire for consensus could smother worthwhile alternative views
- Can be time-consuming
- Needs high participant motivation

3. Game theory

3.1. Introduction

Increasingly, companies are using game theory to help them make strategic decisions in competitive markets. Game theory has been shown to be able to generate the ideal strategic choice in a variety of environments.

Game theory uses well-defined scenarios involving a number of players (individuals or firms) each of who can make their own specific choices. Payoffs are calculated for each combination of choices. The choices made by one player affect the rewards received by the other players; the other players know this and will act accordingly. Therefore, when making a decision or choosing a strategy firms must take into account the potential choices and payoffs of others, remembering that while making their choices, other firms will take into account your strategy as well.

Game theory is suitable where combinations of choices and their outcomes can be modelled. For example, in sealed bid auctions the more you bid, the more likely you are to win the contract, but the more likely that it will be unprofitable. Other bidders know that too.

It assumes:

- Players act rationally and for the long term benefit of their organisation.
- The various payoffs can be calculated.
- Typically, games are played many times to model different potential strategies and decisions. The games should help to answer questions such as:
- What are the recommended strategic needed to achieve an acceptable outcome
- How a series of possible strategic moves can predict outcomes.

For making economic decisions, many-person non-zero-sum games, where it pays to cooperate, are used most often. For example, a supplier of components is considering increasing the quality of the components. The buyer of the components has to decide whether to pay for the quality improvements. Both parties know that better products will generate an improved reputation and hence increased sales and increased profits. Hence this is non-zero sum as both parties can win through quality improvements. Both parties know this so can use that knowledge to negotiate the new supply price of the components.

3.2. Example

		Company A	
		Hold price	*Reduce price*
Company B	*Hold price*	$10m, $10m	$0m (B),+$20m (A)
	Reduce price	+ $20m (B), $0m (A)	+$5m, +$5m

In this example, we have an oligopoly of Company A and Company B. They supply identical goods to the market and are deciding on next year's prices. Once the prices are announced they apply for the year. Both companies have to announce their prices at the same time

On first glance it might seem wisest if both hold their prices and each earns $10m, but we need to look a little more closely at the decision.

Put yourself in Company A's position:

If company A holds its price and Company B holds its price than each will earn $10m. If however, Company A reduced its price and Company B held its, then Company A would earn $20m. So in that scenario, Company A should reduce its price irrespective of what Company B does.

If company A holds its price and Company B reduces its price than Company A will earn $0m. If however, Company A reduced its price and Company B reduced its, then Company A would earn $5m. So in that scenario, Company A should reduce its price.

Therefore, irrespective of what Company B might do, Company A will be better off reducing its prices.

Because the situation is symmetrical for Company B, that company will also be better off by reducing prices. So both companies should take the decision to reduce their prices to give certainty of income.

So, the best outcome has been decided by looking at the moves (or strategies) that competing companies can take.

4. Regression (trend) analysis

4.1. Introduction

Linear regression is a method of fitting the best straight line through a set of points. In business, typically the line would connect points showing:

- Cost and volume
- Selling price and sales volume
- Hours worked and units produced

Linear regression will give constants which fit a line of the type:

y = ax + b

where:

y is the dependent variable (cost, hours, volume sold)

x is the independent variable (units made, selling price).

The constant 'a', for example, could be the additional cost for each additional unit made; 'b' would be the cost even if no units were made (the fixed cost).

4.2. Linear regression – caution

Be warned: linear regression will give the best line it can through any set of points. For example, if you numbered the days in the year 1 – 365 and you noted the day each person was born and the amount of money they had in their bank account, linear regression would suggest the best relationship it could between these variables. Obviously there would not be a good relationship.

To test the relationship you must calculate the coefficient of correlation (r), or the coefficient of determination (r^2).

r can vary between:

- r = +1, meaning perfect positive correlation where all points lie on the line and as one variable increases, so does the other.
- r = -1, meaning perfect negative correlation where all points lie on the line and as one variable increases, the other decreases.

r = 0 means no correlation.

If r = 0.7, r^2 = 0.49 or about 50%. This means that 50% of the change in one variable is explained by the change in the other.

You should be aware of the following before you rely on any prediction based on linear regression:

- If r r^2 is low, then one variable is not well-associated with the other, so any predictions are liable to be poor.
- The more points (readings) the better: simply more evidence for the association.
- Extrapolation (predicting outside the range examined) is dangerous as we have no direct evidence of what happens in other regions. For example, costs might suddenly increase.
- Other known influences (such as inflation) should be removed before the analysis.
- Even good correlation does no prove cause and effect: both variables might have moved together under the influence of another variable.

5. Time series analysis

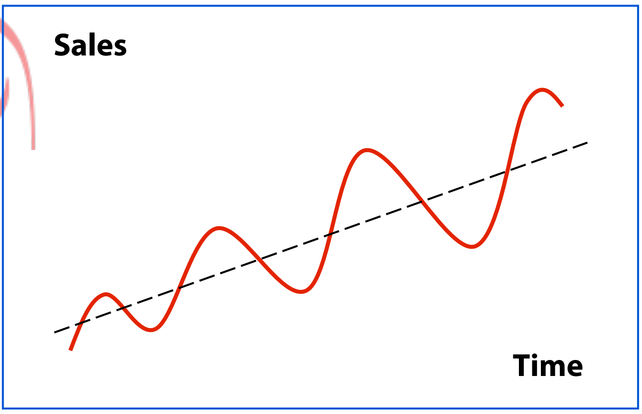
A time series is simply one that moves with time: sales each day, rainfall each month, machine breakdowns each week.

There are four components of a time series:

- The trend – an underlying increase/decrease
- Seasonal variations – regular variations with a cycle length of less than a year.
- Cyclical variations – regular variations with a cycle length of more than a year
- Random variations – irregular and unpredictable.

Time series analysis tries to analyse the first two of these, the trend and seasonal variations.

The figure below shows a rising trend with regular seasonal variations.



Example:

Assume that the trend in sales of a product has been calculated as an increase of $10m per quarter year, and that the seasonal variations have been calculated as:

- Spring +20%,
- Summer + 10%
- Autumn 0%
- Winter -20%

Sales for the last quarter, winter 2015, were $240m.

What are the projected sales for Summer 2016?

Solution:

The sales of $240m in winter 2015 had suffered a seasonal variation of -20%, so represent 80% of the underlying trend.

Winter 2015 sales without the seasonal variation would be $240m/0.8 = $300m

To get to the trend figure for Summer 2016, we have to move two quarters further on and each will add $10m to sales.

Summer 2016 trend sales = 300 + 2 x 10 = $320m

This has to be adjusted by the +20% seasonal variation appropriate for summer: $320m x 1.2 = $384m

Note: as with linear regression, even historically reliable behaviour is no guarantee that the same patterns will be found in the future.

6. Scenario planning

Scenario planning is "building plausible views about how the business environment of an organisation might develop in the future….based on sets of key drivers about which there is a high degree of uncertainty".

The emphasis is on developing **plausible, internally consistent** views so it must take into account all the things that could happen and from those to build a number of believable, alternative futures. This greatly helps to reduce the number of 'universes' have to be considered and allows the organisation to concentrate on the few most likely ones.

Without choosing a few plausible combinations of events organisations rapidly find they would have to deal with a huge number of possible permutations. For example, let's say that the key drivers for an organisation are:

(1) Which party wins an up-coming election, Party A or Party B

(2) Interest rates, 3% or 7%

Even with only two variables there are already four permutations:

	Party A	*Party B*
3% interest	A, 3%	B,3%
7% interest	A, 7%	B,7%

In fact the number of permutations where there are N variables is 2^N.

The permutations can be reduced by seeing which combinations are plausible. For example, it might be known that Party A favours high government spending and to raise money it must borrow and raise interest rates to attract lenders. Party B however, favours austerity, doesn't wish to borrow, so interest rates remain low.

This simplifies planning to just two scenarios:

	Party A	*Party B*
3% interest	Implausible	Plausible
7% interest	Plausible	Implausible

Business plans and forecasts can now be devised for each plausible scenario

Steps in scenario planning

(1) Define the scope, for example: What time horizon? Which part of the business? Which country (for multi-national organisations)?

(2) Identify which factors will most affect the organisation.

(3) What are the plausible outcomes for each factor?

(4) What are the plausible, internally consistent combinations of factors?

(5) What are the effects of these scenarios on the organisation respond?

(6) How should the organisation respond? For example, it could decide to retreat to an internet-only presence, it could move up-market/down-market, or it could withdraw from the market.

(7) Go back and recheck assumptions and scenarios in the light of decision made as some decisions might affect these.

Advantages and disadvantages of scenario planning

Scenario planning can have the following advantages:

It challenges managers and other stakeholders to be more forward-looking when business planning

It challenges assumptions about the future, and about the drivers and forces that influence its industry sector.

It forces managers to consider previously unimagined possibilities and tests the rational for current strategies.

It does not attempt to forecast *the* future – almost certainly a lost cause. Instead it results in several outcomes, each of which can have a planned response.

It encourages communication and planning within the company as scenario building requires inputs from many areas.

- It can encourage the identification and evaluation of 'weak signals'. Weak signals are small signs of changes that do not currently have much effect but which might be game-changing in the future. For example, early adopters of Facebook might have used it for purely personal use, but some might have foreseen the major effect it would have on marketing.

Scenario planning can have the following disadvantages:

- It can be very time-consuming: identification of all the relevant variables, collection of data and the distillation to a few plausible, internally consistent scenarios.
- It is important to use experts who can assess possible outcomes – and the cost of experts' time can be considerable.
- It is important not to eliminate all scenarios except the most likely one or the most attractive one. The point of scenario planning is to obtain a range of possibilities – both favourable and unfavourable - and to plan for those.

7. Real options

Real options can give managers valuable flexibility when assessing projects or likely future events. They can certainly be worth paying for when the future is uncertain – as it usually is.

Option to delay

Instead of starting a project immediately, this option allows it to be delayed, perhaps until better estimates about the future are available or until after a future even has occurred. For example, instead of immediately entering into a five year distribution and support agreement for a new product to be supplied by a foreign manufacturer, it might be useful to have the option to enter an exclusive agreement any time within the next two years. That way, based on sales of the product made in overseas markets, you could better judge whether the manufacturers' product would be likely to be successful in your home market.

Option to follow on

For example, if the product described above had been successful and it was now getting close to the end of the five year agreement, an option to follow on would give you the exclusive right to renew the agreement for some more years.

Option to abandon

No mystery about this. It is an option that allows you to escape early from a project of contract. An example would be renting an office on a five year lease with a 'break clause' after two years.

Chapter 14

CHANGE MANAGEMENT AND CULTURE

1. Change management

All organisations have to change in response to drivers such as:

- New technology
- Political events
- Economic events
- Competitor action
- Legal changes

In general, a refusal or inability to change and adapt where necessary will lead to the failure of the organisation. Not even a variable such as 'quality' or 'service' is sacred as has been demonstrated by the growth of no-frills airlines. At one time airlines took pride in their inflight catering and seat room even on short-haul flights. Then they discovered that many passengers would prefer cheaper fares but lower service standards.

Deciding what changes are necessary is part of strategic planning and marketing. This chapter deals with how changes can be managed without causing too much disruption to the organisation.

2. The business change life-cycle

2.1. Overview

There are a number of versions of the stages that make up the business change lifecycle. Typical are the following stages:

1. **Planning:** define the goals. What will be achieved as a result of the change? Also at this stage people must be allocated responsibilities.

2. **Analyse existing activities**. This is usually an essential starting point to all business change processes. The existing systems might not be perfect but they will usually achieve at least the bare minimum required of operations which can be built on and improved. Identifying problems with the existing system will point the way to where improvements are needed.

3. **Design a new or improved process**. Explore alternatives and choose the best redesign that achieves the goals set.

4. **Development.** Redesign products and services and devise ways in which the success of processes can be measured.

5. **Implement/transition.** This will include training employees and overcoming any resistance they might have.

6. **Review** the success of the new business process.

2.2. The POPIT model

POPIT: people, organisation, processes, information technology

This approach to business change suggests that four elements need to be considered to achieve successful business change: people, organisation, processes, and information technology

- People: roles, job descriptions, competences, motivation, rewards, culture.
- Organisation: consider the organisational capabilities and structure and ensure that these are suitable.
- Processes: how are the core business processes carried out? Analyse the value chain and understand the processes (activities) and their linkages.
- Information technology: IT architecture, IT capabilities, controls, software and information provision.

Any proposed change has to be assessed for feasibility:

- The cost and benefits of the proposed change
- Technically feasibility
- Operational feasibility
- Socially acceptability

2.3. Organisational culture

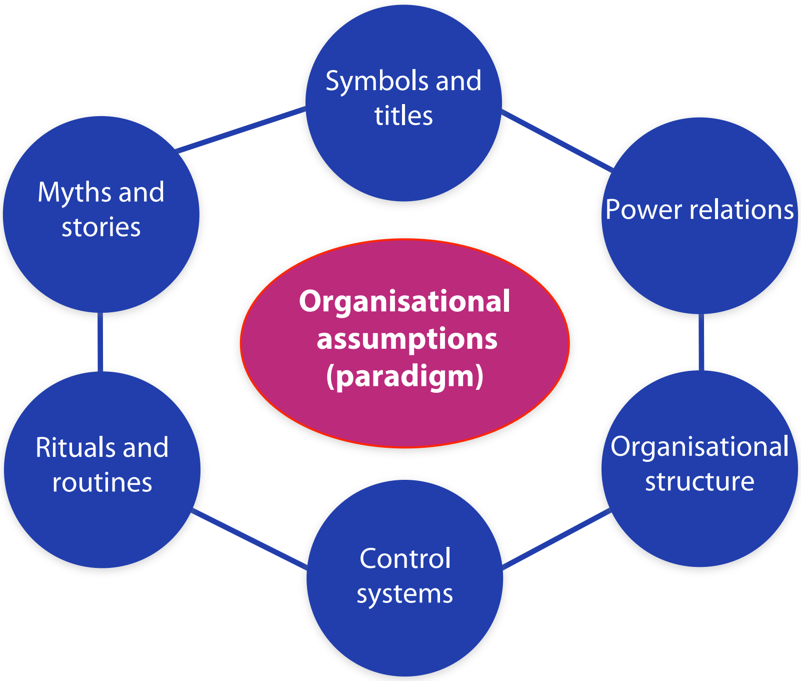
Charles Handy defined the corporate culture as "the way we do things around here", and culture is something to which we are all very sensitive. For example, whenever we change job, we go carefully for a little while to see how people do things: the level of formality, dress codes, how they address each other, length of the working day. As you will see below in the cultural web, there are many influences on culture, but then it tends to reside in the outlook and behaviour of the people in the organisation.

It is important for organisations to get their corporate culture right as this will affect how the organisation performs. For example:

- A cost leadership strategy will require close control of expenditure and might be expected to have strict manager-subordinate relationships.
- A differentiation strategy would require less cost control and different priorities (such as ensuring very high customer satisfaction). The organisational assumptions in those types of business would also be different.

3. The cultural web

The cultural web describes the various influences that determine corporate culture:



- Symbols and titles. Do the members of the board have reserved parking places? Do they have very large offices or do they tend to share an open plan office with other employees?
- Power relations. Does your boss always tell you what to do or do you usually discuss what should be done and come to a consensus?
- Organisational structure. We will see later that organisations can have what is called a tall narrow shape or a wide flat shape. The tall narrow shape tends to result an organisations which are rather bureaucratic and formal; wide flat tends to produce less formal cultures.
- Control systems. How carefully are you controlled? How much are you allowed to use your own initiative? What reporting mechanisms are there?

- Rituals and routines. Some telephone-sales orientated organisations have a ritual that people, for example, ring a bell whenever a sale is made.
- Myths and stories. For example, how in the past the company beat a powerful competitor.
- Organisational assumptions. These can often be difficult to pin down, but a typical assumption is that we are the best, or we never fail or we never miss a deadline. A hospital might have the assumption that its purpose is to provide healthcare irrespective of cost.

The outer elements of the cultural web are usually the easiest to identify. You very quickly begin to appreciate the power relations, control systems, symbols and titles. However, many of these elements of culture will be relatively superficial. Usually the most important element of a culture will be the organisational assumption which is often the most difficult to identify. Therefore organisations often work hard to try to instil these assumptions in their employees.

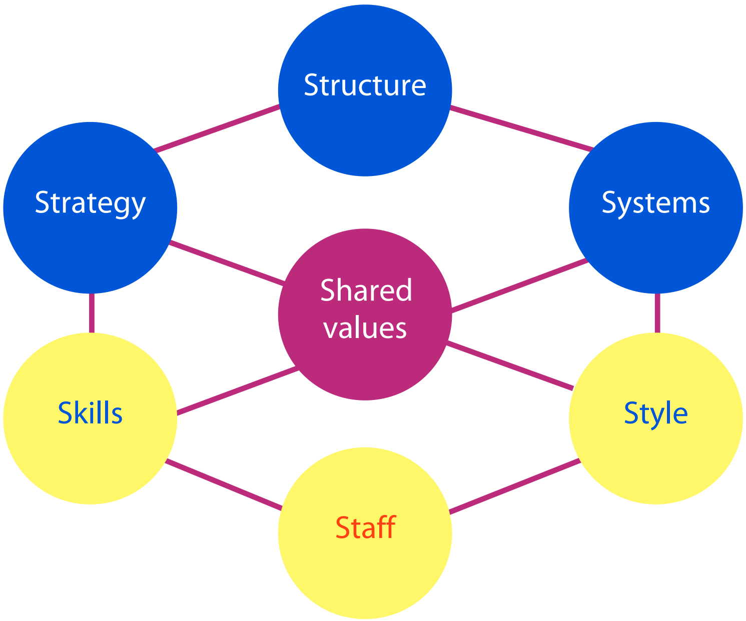
4. Culture classification

Organisational cultures can be classified in many ways. One of the easiest is this one by Charles Handy. He describes four types of culture: power, role, task, and person.

- Power culture. In the power culture, all or nearly all power is concentrated in the hands of one person. Organisations with this culture often are small, perhaps family, organisations and the person who has the power is probably the founder. As organisations grow, it becomes increasingly difficult for this person to successfully wield power as there are simply too much to do and too much to know. However, even in some large organisations there can be a very charismatic Chief Executive Officer who with force of personality manages to wield great power. This can result in successful organisations, but auditors and investors should worry that perhaps one person wields too much power. Current corporate governance rules suggest that the Chief Executive Officer and the Chairman should be different people so the power at the top is spread.
- Role culture. As organisations grow, role cultures become more common. Role cultures are essentially bureaucracies. There tends to be great task specialisation, many layers and titles, great formality. In stable environments, this can be an inefficient organisational culture, but it tends to be rather slow to adapt to change. Furthermore, employees think that their role and job title is more important than the work they actually do.
- Task culture. This is a more modern type of culture. Here employees do not concentrate so much on their role or title. Instead they concentrate on getting the task done and achieving organisational success. They will tend to be highly motivated, flexible, adaptable, and eager to learn.
- Person culture. This isn’t of great importance in most organisations. It refers to an organisation where the people are really pursuing their own particular ambitions. They may have to be in a particular organisation to fulfil that, but they are not really interested in the organisation so much as doing what they want. Perhaps a talented surgeon in a hospital might fall into this category. They have to be in a hospital to make use of the infrastructure, but what they really like doing is operating and curing people. Their interaction with the organisation is kept at a minimum.

5. McKinsey 7S Model

The McKinsey 7S Model sets out the areas of an organisation that can need attention when the organisation wants to change to adopt a particular strategy.



The model can present a useful checklist and what has to be considered when try to put the chosen strategy into effect. The three items across the top (strategy, structure and systems) are known as the 'hard Ss'. These are relatively easy to capture, to write down, and to communicate.

The three across the bottom (skills, staff and style) are known as the soft Ss. These are more difficult to capture, define, and communicate.

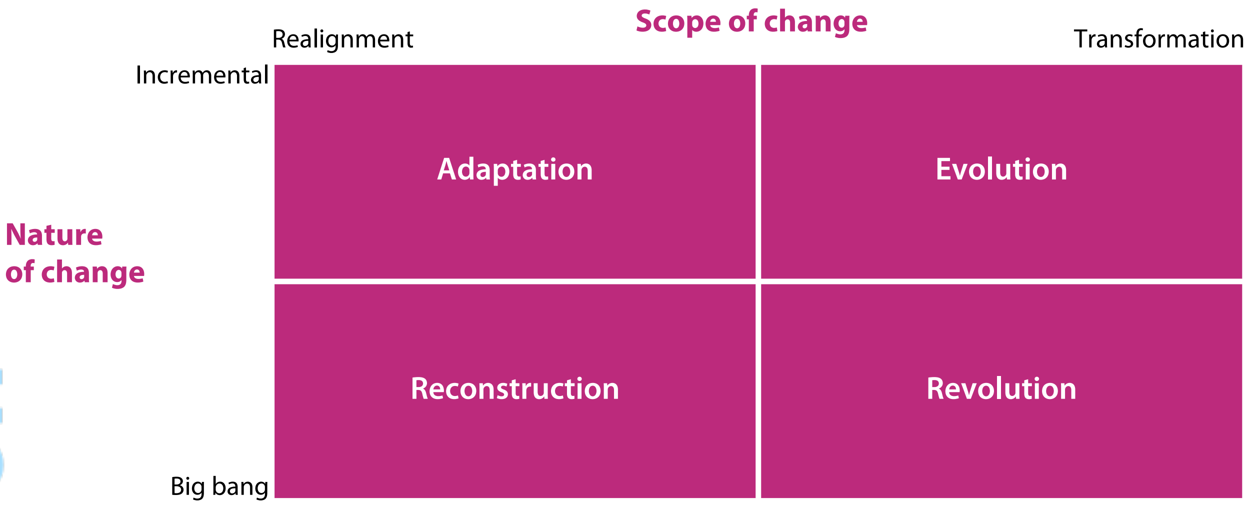
In the centre almost holding all of these together are the organisation's shared values.

Probably, elements of corporate culture (which we will look at in a moment) come closest to dealing with shared values: What do people believe about the organisation? What is it for? How should it act? How could success be defined?

For example, if the chosen generic strategy was to be a cost leader, then the impact of this on the 7S's could be:

- Strategy – a generic strategy of cost leadership
- Structure – wide flat simply structure with few managers and a very lean head office.
- Systems – focused on high automation and efficiency
- Style – dictatorial: just get on with your job. Close monitoring of performance and efficiency of staff.
- Staff – paid as little as possible compatible with the job to be done.
- Skills – Training would be very task orientated to equip staff with the precise skills needed. Little by way of general development.
- Shared values – provision of a basis product or service at low cost to ourselves. Costs have to be watched very carefully. Tough approach to budget enforcement.

6. Types of change



Scope of change

Nature of change

	Realignment	Transformation
Incremental	Adaptation	Evolution
Big bang	Reconstruction	Revolution

The scope of change relates to the size of the change and how fundamental it is. For example, if every department were being affected the scope would be transformational (large). Similarly, if the fundamental nature of the business was being changed, such as moving from being a cost leader to a differentiator), the scope would again be transformational.

The nature of the change deals with its speed.

You can remember the top two quadrants from biological terms. Adaptation means slow, small changes. Evolution means slow large changes. Because the changes are incremental, these types of change are relatively *low risk* as the change process can be halted or reversed if it's not going well.

Revolution is obviously a large, fast change. There is a high risk of things going wrong in a big way.

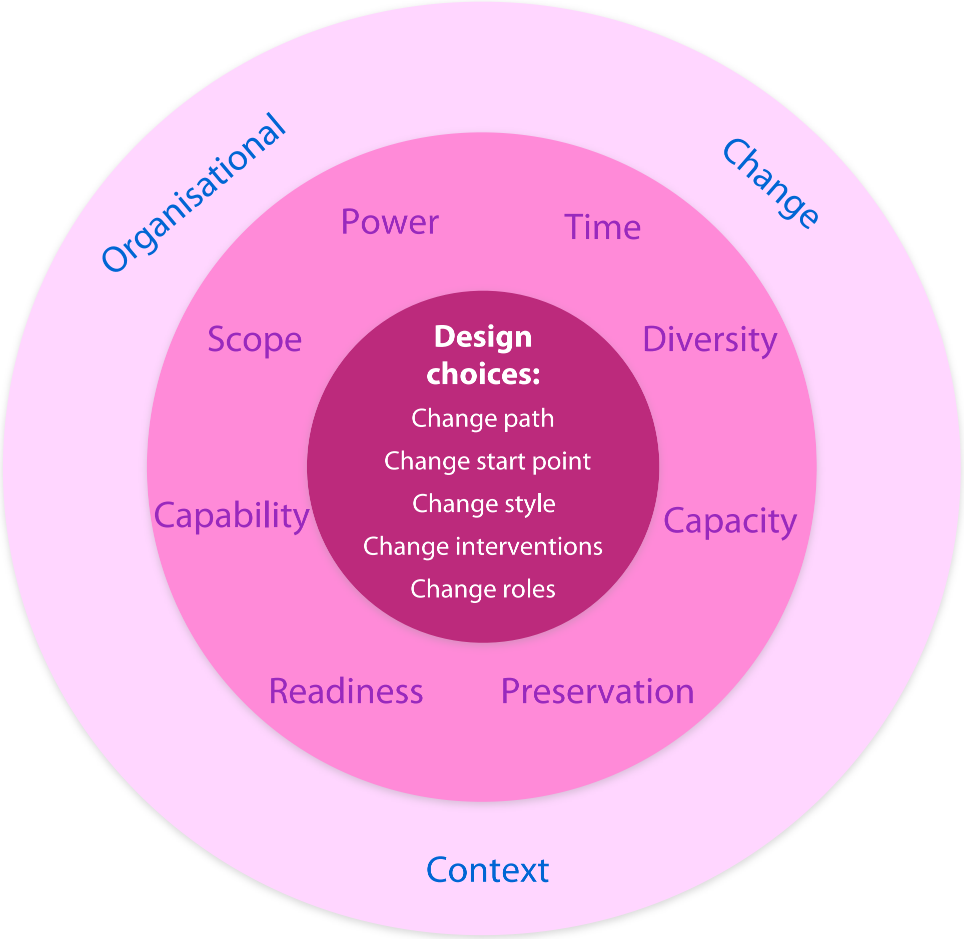
Reconstruction is a fast change of limited consequences. Obviously its speed means that things can go wrong, but as the extent of the change is limited, any damage should be limited to relatively few stakeholders and it should be relatively easy to put it right again.

7. Methods of managing change

7.1. Balogun and Hope Hailey

Balogun and Hope Hailey

It's usually assumed that there will be resistance to change. People may fear that they will lose their jobs, they may fear that their job will be a worse one, they may fear that they won't be able to cope with a new role. You will see later ways in which resistance to change might be overcome. However, even if resistance is not strong, major change is likely to be a difficult time for an organisation. This diagram, the Balogun and Hope Hailey kaleidoscope, sets out certain variables that could be present in the change context and then sets out certain design choices that might then be appropriate.



Contextual features

First, we can look at the contextual features of the change, i.e. the variables that determine the nature of each change event.

- Time: What is the time span? Do we have a long time, or is it urgent? You can probably predict from this, that if a change is urgent, the change process is likely to be one where people tend to be told what to do rather than having long discussions about what should be done.
- Scope. How much of the organisation is affected? If most of it is affected then the change process is much more complex. If it is more restricted the change process would be much easier.
- Preservation. Which aspects of the organisation work well and therefore are to be retained? We must be careful not to damage those.
- Diversity. Some parts of the organisation may be keen to embrace change whereas others resisted and are protective of their current position.
- Capability. Can we do the change or we need outside experts?
- Capacity. Do we have enough resources and time, money, and expertise or do we need to buy some in?
- Readiness. Are staff members aware of the need for change, committed to it, anxious for it and ready to embrace it?
- Power. How much power does the change agent have? If that person has to keep referring upwards to get guidance, then to some extent their position and power is undermined.

Design choices

Having looked at the context (the environment) of the change and the variables determining this, we can now look at various design choices.

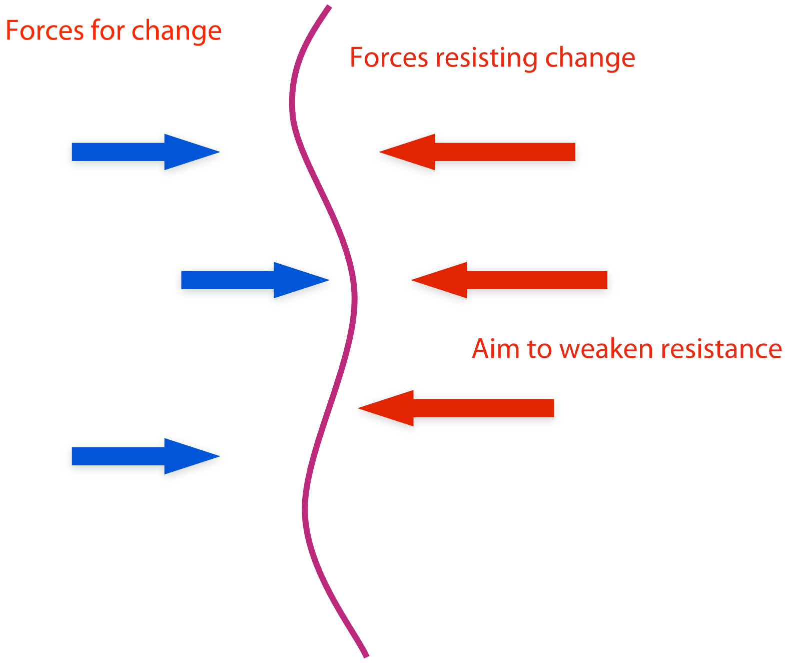
- Change path. What are the time scales? What is the extent of the change? How do we know when an outcome has been achieved?
- Change start point. Are we going to impose change top-down, or are we going to go to our employees and ask them to suggest what changes may be required?
- Change style. Is it going to be very dictatorial or much more participative?
- Change interventions. These can consist of educating people, communicating the need for change and cultural interventions. For example, team building or getting people to be more flexible and to be willing to work in a variety of project teams.
- Change roles. Who is going to be responsible for carrying out the change? Are we going to bring in outside consultants? Are we going to have a project team with a project leader? Is it all going to be managed by, for example the managing director?

The design choices need to be made remembering the contextual features that we discussed above.

7.2. Force field analysis

As mentioned earlier, the normal assumption is that change will be resisted by employees, and even if it's not resisted very strongly there is likely to be a period where employees are nervous and there will be a certain amount of disruption. It's important for companies to try to manage change so that disruption and resistance are both minimised. There are number of techniques that can help.

The first one shown here is **Lewin's Force Field Analysis.**



Lewin says that on one side there are forces for change. The assumption is that these changes will set up forces resisting them. It could be just individual employees who object or it could be more highly organised through a trade union or works council. The wrong approach, according to Lewin, is for management to push very hard one way because the chances are that the forces resisting change will just push equally hard the other way, and the whole conflict escalates so that there is a serious risk of industrial unrest and strikes and work-to-rules.

Lewin says that instead of taking on the resisting forces head-on, management should aim to weaken resistance to change. So, how do you weaken resistance to change? Well, the suggested ways are:

- Communication. Often resistance to change is there because people simply don't know what is happening. They fear for their jobs or perhaps there are no plans to make anyone redundant. If people are worried that they won't be able to use the new system you can say that training will be provided for everyone. Communication should also include reasons why change is needed. You could say to people that if we don't change we can't compete and if we can't compete there will a contraction of the business.
- Participation. If you explain to people why change is needed and then ask them to make suggestions about the change in the structure of the company (a kind of bottom-up approach) it is subsequently quite difficult for them to object to suggestions that they have made themselves.

7.3. Lewin – 3 step method

Lewin’s second suggestion for managing change is his three-step process which effectively is very similar to his Force Field Analysis, though not using quite the same analogy. Here he says:

- First, management must first unfreeze the current situation. Explain to people why change is needed, get them ready for change. Ideally, get them ready to embrace change.
- Second, you put through the changes. This can be a relatively long period where people will have to perhaps undergo retraining and restructuring.
- Third, refreeze the situation. Let things settle down, have a period of calm where things refreeze and become stable in a new environment. Above all make sure that people don’t slip back into old patterns of behaviour.

8. Change agent

The third approach which management should consider is the use of a change agent, who will normally be an outside consultant. Consultants can be very expensive but there can be very considerable advantages in hiring one to oversee the entire change process:

They are skilled in the process of change. They know that people would be unsettled. They know for example the importance of communication and how useful it could be if people were allowed to participate in the change process by making suggestions.

A consultant might typically visit half a dozen different companies in a year. They therefore know the types of management structure which might be suitable. They know which processes could perhaps be successfully outsourced. They therefore bring enormous knowledge and expertise to the type of change that is needed, not just to the way in which the change should be affected.

They are perceived as being independent and fair. They come to the company with a clean pair of hands. They won’t be creating a good job for themselves. They won’t be getting even with rivals and people they don’t like within the company. They won’t be trying to preserve previous changes which they put through earlier in their management career.

Management knows that if the change process goes wrong, it could be extremely serious for the company and they may feel nervous about that. Therefore, they may want someone to effectively hold their hand and to give advice; it’s someone for management to transfer risk to. If after the event, management can say, “Look we went to one of the most respectable firms of consultants; we did everything we could to get this right. Okay, things aren’t perfect, but there is nothing more we could have done. We had the best advice that money could buy.”

9. Change styles

The styles of management change set out below, are to some extent are reworking and expansion of the designed choices in the Balogun and Hope Hailey kaleidoscope of change model.

- Education and communication
- Collaboration and participation
- Intervention – change agent retains control and delegates
- Direction – use of authority
- Coercion or edict – explicit use of power through edict It must be emphasised that the styles of management change are not to be mutually exclusively and many change processes will use a mixture of styles. We have already mentioned the styles in the first two bullet points above - the importance of communication, participation, collaboration, and educating people as to why change is necessary.

Intervention is where the change agent may retain overall control, but delegates the change process to various people within the organisation.

How fierce is it the control retained going to be? Well, the change agent whether an internal manager or an external consultant could simply tell people what to do. The change agent for example, could tell someone that they must save cost of 10% but then leave it up to them to decide how they do it; or the change agent will be more direct and say you must save costs by cutting 10% of your workforce. That's direction or use of authority.

This can go even further; the change agent could for example, simply close down one of the departments or one of the factories. Essentially, that's coercion or edict, the explicit use of power: you simply announce this department will close at the end of the month.

You may think that the use of an edict is not an absolutely desirable way in which changes should be put through, but remember it does depend on the contextual features. What is the situation? If the company is facing bankruptcy then coercion and edict may be the most suitable style for change because it is very quick. If however you have to respond to complex changes in the market and the changes in technology, then coercion and edict could be very dangerous as you may drive away your best people; you may not know what changes are required anyhow. It may be your workforce with the best ideas and the expertise. Therefore education, communication, collaboration, or participation in that context of change may be far more successful

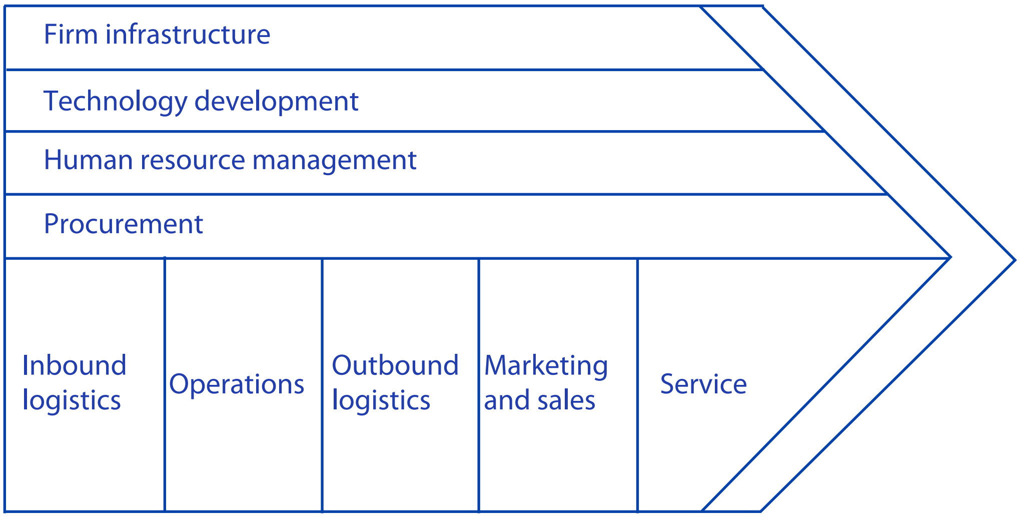
Chapter 15

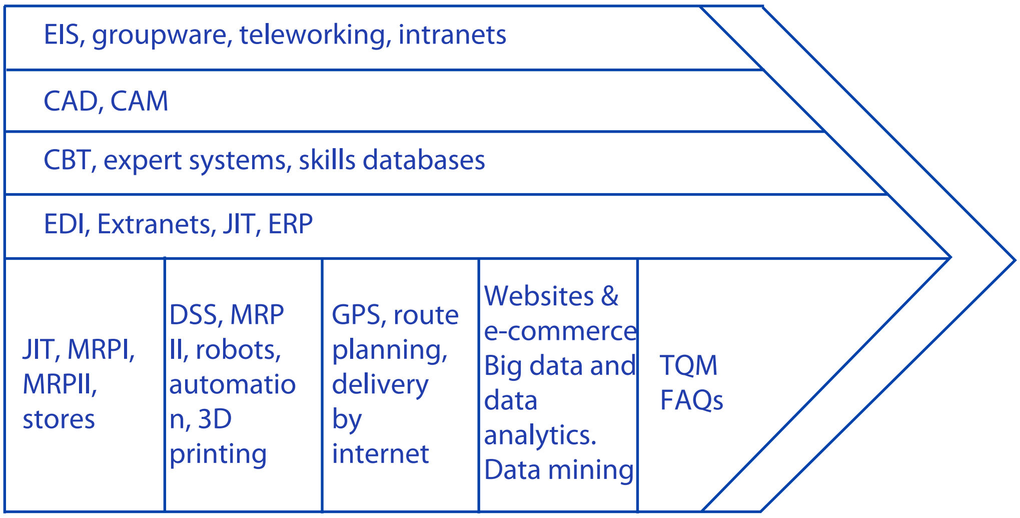
INTRODUCTION TO DATA, INFORMATION, KNOWLEDGE AND IT

1. Introduction

We now turn to look at the roles that information technology can play in modern businesses.

To show how pervasive IT can be in a modern business, the basic value chain is shown below and then we show examples of how each element can make use of IT




EIS, groupware, teleworking, intranets
CAD, CAM
CBT, expert systems, skills databases
EDI, Extranets, JIT, ERP
JIT, MRPI, MRPII, stores
DSS, MRP II, robots, automation, 3D printing
GPS, route planning, delivery by internet
Websites & e-commerce Big data and data analytics. Data mining
TQM FAQs

EIS: executive information system (see below)

Groupware: allows collaboration on document production and the sharing of information

Intranet: internal internet.

CAD: computer aided design – greatly speeds up getting new products to market

CAM: computer aided manufacture – can link to CAD to substantially automate production.

EDI: electronic data interchange, such as sending orders to suppliers over the internet

Extranets: gaining access to another company's intranet

JIT: just-in-time inventory and manufacturing to reduce inventory and wastage. Requires automation to make it reliable and cost efficient.

ERP: enterprise resource planning. Trying to tie everything together: sales orders, purchases, labour, scheduling and cash flows.

MRPI: materials resource planning – planning the material you need based on orders received

MRPII: manufacturing resource planning – planning material, labour and machine time based on orders received.

DSS: decision support system (see below)

GPS: global positioning satellite technology

Data ware houses and data mining (see big data, below)

TQM: total quality management – log faults to try to reduce them in the future

FAQs: frequently asked question pages.

2. Data information and knowledge

We have to look briefly at a number of definitions:

- **Data**

  Data is raw fact. For example, a list of all the entries in the sales ledger is data. Data is not, of itself, particularly useful nor informative. Before it is useful normally some sort of processing has to be performed on it. The processing could simply be summarisation or it could be more complex.

- **Information**

  Data with meaning is known as information. So the receivables ledger total, the total for each customer and age listings, are information. Some times graphics are used to allow us to visualize the information. Information allows us to make decisions that would be difficult to make had the data simply remained as raw fact.

- **Knowledge**

  Although data might be processed into information that information could rest unseen in a file. If that's all it happens to information it's next to useless. Before the information becomes really useful it has to get into people's minds. People have to read it; they have to think about it. Then it becomes knowledge. Knowledge can be defined as information in someone's mind.

There are two types of knowledge

- Explicit knowledge. Generally that's the knowledge which is written down. We know where to find it, we know what it is. It has been captured.
- Tacit or silent knowledge. Information that people don't even know they possess. For example, a sales representative is likely to know who the important customers are and roughly what their turnover is in a year. The sales department will probably know their address and perhaps even their telephone number. All of that is explicit knowledge, and it is probably written down on a database somewhere. However, what makes a good sales representative as opposed to a merely average sale representative is the ability of that person to make additional sales and this is likely to rely upon tacit or silent knowledge. The sales representative may know what that person has been planning. The sales representative will know who likes to be phoned up out of the blue, who doesn't. The sales representative will know who makes decisions quickly, who makes decisions slowly. None of that information is likely to be written down, but it's very, very important. It's what makes the sales representative particularly effective.

3. Knowledge management

The importance of knowledge, in particular tacit knowledge, has now been recognised. Knowledge management is the process of:

- Uncovering or discovering knowledge
- Recording it
- Distributing it to those who may require it Levering it, thus making knowledge acquired for one purpose useful for another purpose
- Ensuring that the knowledge is updated and remains current.

Increasingly, many economies depend on service industries, and capturing what makes a good service is difficult. How do we get on with clients and customers? What do they want? What do they appreciate? All of that is much more likely to be tacit knowledge than explicit knowledge.

IT, for example intranets, can be important in knowledge management. But many experts will maintain that what is really effective in knowledge management and in particular uncovering tacit knowledge is the telling of anecdotes i.e. stories in a relatively informal atmosphere. Chatting with colleagues is important.

4. Types of business information systems

- **Transaction processing systems (TPS)**

  The first business computer applications were for recording transactions such as wages and salaries processing, the production of sales invoices and receivables ledger accounting. These systems are known as 'transaction processing systems' and they automate existing operations allowing greater accuracy, more speed and cheaper processing.

- **Management information systems (MIS)**

  Once transactions are recorded in a computer it is easy to analyse those transactions to produce information that could be useful for management and IT operations then became known as 'management information systems'. For example, once the sales ledger is computerised it is easy to produce aged receivables listings.

  The systems could also be programmed to make simple decisions such comparing inventory levels to production plans to enable automatic stock ordering or approving new orders by comparing credit limits to customer balance and new order value.

- **Decision support systems (DSS)**

  Not all decisions are structured. For example, there is no definitively correct way to draft next year's budget or to decide on the selling price of a new product. DSS help managers to make decisions.

  A good example is seen in the use of spreadsheets where financial models created on spreadsheets allow managers to try out "what if?" experiments where they try out different combinations of assumptions and try to home in on a credible answer.

- **Executive information systems (EIS)**

  These are aimed at senior managers and they have a particular emphasis on giving access to external information that is needed for operational and strategic planning (eg through the internet and access to external databases). Executive information systems also emphasise flexibility so that executives can see company data in a wide variety of ways and they can 'drill down' top greater detail when needed.

5. Networks

Only the very smallest of businesses will have stand-alone computers ie computers not connected to other computers. Even in small businesses employees need to share data and very soon after personal computers were invented networks of computers were introduced. There are two main types:

- **Local area network (LAN)**

  Here the network extends over only a relatively small area, such as an office, a university campus or a hospital. The small area means that these networks use specially installed wiring to connect the machines.

- **Wide area networks (WAN)**

  Here the network can extend between several cities and countries. Each office would have its LAN, but that connects to LANs in other cities and countries using commercial, public communications systems and setting up a virtual private network (VPN) which allow data to be transmitted securely over the internet between any two locations. Because data is being transmitted over public systems it is particularly vulnerable to interception and it is very important that adequate security measures are in place to safeguard the data.

- **Intranets**

  An organisation's internal internet based on a LAN or WAN. Extremely useful for quickly providing internal information and bulletins to everyone. The information is accessed using a web-browser.

- **Extranet**

  Where one organisation's intranet can access another organisation's intranet. For example, to automatically see if a supplier has inventory available

Chapter 16

MORE MODERN DIGITAL TECHNOLOGIES

1. Big data

1.1. Introduction

There are many definitions of the term ‘big data’ but most suggest something like the following:

“Extremely large collections of data (data sets) that may be analysed to reveal patterns, trends, and associations, especially relating to human behaviour and interactions.”

In addition, many definitions state that the data sets are so large that conventional methods of storing and processing the data will not work.

These characteristics, and sometimes additional ones, have been generally adopted as essential qualities of big data. The information held in big data is often referred to as a **data warehouse.**

1.2. Characteristics of big data

Big data displays the following characteristics:

- Volume: a very large amount of data. More than can be easily handled by a single computer, spreadsheet or conventional database system
- Variety: disparate non-uniform data of different sizes, sources, shape, arriving irregularly, some from internal sources and some from external sources, some structured, but much of it is unstructured
- Velocity: data arrives continually and often has to be processed very quickly to yield useful results

The commonest fourth ‘V’ that is sometimes added is veracity: Is the data true? Can its accuracy be relied upon?

1.3. Volume

The volume of big data held by large companies such as Walmart (supermarkets), Apple and eBay is measured in multiple petabytes. What's a petabyte? It's 10^{15} bytes (characters) of information. A typical disc on a personal computer (PC) holds 10^9 bytes (a gigabyte), so the big data depositories of these companies hold at least the data that could typically be held on 1 million PCs, perhaps even 10 to 20 million PCs.

These numbers probably mean little even when converted into equivalent PCs. It is more instructive to list some of the types of data that large companies will typically store.

- Retailers, by loyalty cards being swiped at checkouts: details of all purchases you make, when, where, how you pay, use of coupons. Through websites: every product you have every looked at, every page you have visited, every product you have ever bought. (To paraphrase a Sting song "Every click you make I'll be watching you".)
- Social media (such as Facebook and Twitter) Friends and contacts, postings made, your location when postings are made, photographs (that can be scanned for identification), any other data you might choose to reveal to the universe.
- Mobile phone companies Numbers you ring, texts you send (which can be automatically scanned for key words), every location your phone has ever been whilst switched on (to an accuracy of a few metres), your browsing habits. Voice mails. Internet providers and browser providers.

  Every site and every page you visit. Information about all downloads and all emails (again these are routinely scanned to provide insights into your interests). Search terms you enter.
- Banking systems. Every receipt, payment, credit card payment information (amount, date, retailer, location), location of ATM machines used.

1.4. Variety

Some of the variety of information can be seen from the examples listed above. In particular, the following types of information are held:

- Browsing activities: sites, pages visited, membership of sites, downloads, searches
- Financial transactions Interests
- Buying habits
- Reaction to ads on the internet or to advertising emails
- Geographical information
- Information about social and business contacts
- Text
- Numerical information
- Graphical information (such as photographs)
- Oral information (such as voice mails)
- Technical information, such as jet engine vibration and temperature analysis

This data can be both structured and unstructured:

- Structured data: this data is stored within defined fields (numerical, text, date etc) often with defined lengths, within a defined record, in a file of similar records. An example of structured data is found in banking systems, which record the receipts and payments from your current account: date, amount, receipt/payment, short explanations such as payee or source of the money. Structured data is easily accessible by well-established database structured query languages.
- Unstructured data: refers to information that does not have a pre-defined data-model. It comes in all shapes and sizes and this variety and irregularities make it difficult to store it in a way that will allow it to be analysed, searched or otherwise used. An often quoted statistic is that 80% of business data is unstructured, residing it in word processor documents, spreadsheets, PowerPoint files, audio, video, social media interactions and map data.

1.5. Velocity

Information must be provided quickly enough to be of use in decision making. For example, in the above store scenario, there would be little use in obtaining the price-comparison information and texting customers once they had left the store. If facial recognition is going to be used by shops and hotels, it has to be more-or less instant so that guests can be welcomed by name.

You will understand that the volume and variety conspire against the third, velocity. Methods have to be found to process huge quantities of non-uniform, awkward data in real-time.

1.6. Big data analytics

The processing of big data is generally known as big data analytics and the methods can be divided into three types:

- Descriptive analytics: This describes what has happened. For example, analyse sales by product, outlet, customer, time and date.
- Predictive analytics: This predicts what will happen. For example, regression and trend analysis could be used to predict demand.
- Prescriptive analytics: Here, descriptive and predictive analytics are taken a stage further and the system sets out the decisions that should be made to maximise profits. For example, if demand at various outlets is predicted then the supply of goods to those outlets can be optimised.
- Other techniques (or terms) that might be used include:
- Data mining: analysing data to identify patterns and establish relationships such as associations (where several events are connected), sequences (where one event leads to another) and correlations.
- Text analytics: scanning text such as emails and word processing documents to extract useful information. It could simply be looking for key-words that indicate an interest in a product or place.
- Voice analytics: as above with audio.
- Statistical analytics: used to identify trends, correlations and changes in behaviour. Google provides web-site owners with Google Analytics that will track many features of website traffic.

The analytical findings can lead to:

- Better marketing
- Better customer service and relationship management
- Increased customer loyalty
- Increased competitive strength
- Increased operational efficiency
- The discovery of new sources of revenue.

1.7. Dangers of big data

Despite the examples of the use of big data in commerce, particularly for marketing and customer relationship management, there are some potential dangers and drawbacks.

- Cost: It is expensive to establish the hardware and analytical software needed, though these costs are continually falling.
- Regulation: Some countries and cultures worry about the amount of information that is being collected and have passed laws governing its collection, storage and use. Breaking a law can have serious reputational and punitive consequences.
- Loss and theft of data: Apart from the consequences arising from regulatory breaches as mentioned above, companies might find themselves open to civil legal action if data were stolen and individuals suffered as a consequence.
- Incorrect data (veracity): If the data held is incorrect or out of date incorrect conclusions are likely. Even if the data is correct, some correlations might be spurious leading to false positive results.
- Employee monitoring: data collection methods allow employees to be monitored in detail every second of the day.
-

2. Blockchain technology

Blockchain technology allows data to be added to a set of records, but once added it cannot be changed without detection.

When a piece of data is added (a 'block') a **hash** amount is calculated by a complex mathematical process. When another block is added (like adding a ling in a chain, hence 'blockchain' the hash of the previous block is also included with the new block and a hash of the whole new block produced.

Any alteration of data in, say the first block, will change its hash, but that will then not agree with what is recorded in the second block, and so on down the chain. The integrity of the records has been interfered with and will lead to internal inconsistency that could only be rectified by huge computational power. New rows can be added, but previous ones cannot be amended or removed without detection.

For example, information in each block could be dealing with ownership, taxes paid and planning permissions given for a piece of land so that the chain of blocks will display everything about the land in a way that cannot be changed, but which can be extended.

Another feature of blockchain technology is that the information is held simultaneously in many computers on a network and the copies of the information are continually compared and validated. This distributed processing effect, known as a **distributed ledger**, means that the blockchain is secure from attack. If one computer is damaged, there are many copies still left on the network.

Cryptocurrencies, such as Bitcoin and Ethereum, make use of blockchain technology to record transaction and ownership. The following is a simplified explanation.

Think of a bitcoin as especially constructed number. It takes enormous computing power to produce a valid number.

When you acquire a bitcoin your record of ownership is entered into the bitcoin's blockchain and you are given a key (like a password) that will let you carry out transactions with the bitcoin.

If you pay someone using the bitcoin, the blockchain is updated with information about that transaction by adding another block. It will note you do not own it and that someone else does and the date and time of the transfer is noted too.

To update the blockchain you have to use the key, so that keeps the transaction secure. You will not be able to spend that bitcoin because the blockchain has recorded that you are no longer the owner. The blockchain is itself secure because of the use of hashing and the distributed recording of the chain. Note that transfers of cryptocurrencies and software value tokens do not require an intermediary such as a bank. This makes transaction faster and cheaper. Effectively, they cut out the intermediaries.

2. Cloud computing

This is relatively new approach but one that is growing in popularity. There is only one copy of the software on the server within a web-based interface. Users log into the web system and their processing is then carried out on the server or a 'cloud' of servers. It appears to each user that they have a local version of the software, but what they are really seeing is the program operating in the server. As more processing is needed more cloud resources can be used and this gives users great flexibility.

Client machines can be 'thin-clients' (ie not powerful) as they do not have to store much data and software nor do they have to carry out much processing. Hardware, software and maintenance costs are greatly reduced, though the system is vulnerable to service disruption.

It can be particularly useful where a company's processing needs are very volatile. For example, a design or engineering company might need very high computing power only when rendering (ie producing detailed graphics) work. Much of the time processing needs are small. Therefore, instead of having a large computer of its own, the design company's work is hosted by a cloud-based computer (whose use is shared). That computer will be powerful enough to deal with intensive processing as needed. Also, designers can work at home, for example, on laptops. The relatively low powered laptop provides the interface but the bulk of the processing is done elsewhere.

Obviously there are risks arising from:

- Loss of communications with the cloud machine.
- Communications that are too slow.
- Confidential data is being held on a third party machine and being transmitted over public communications systems.

3. 3-D printing

3-D printing is also known as additive manufacturing. Many traditional manufacturing processes involve taking a piece of material and drilling holes in it cutting into the required shape. These processes remove material. By contrast, 3-D printing involves adding material layer by layer to gradually built up the required shape. The resultant shape can be much more complex than can be achieved by traditional subtractive manufacturing.

Engineers can design components using computer-aided design data (CAD) and this data can then be used to power the 3-D print process. No skilled machine operator is needed to turn drawings into components.

This makes rapid-prototyping easy (where designs are tried out before full manufacturing) and can also be used to make once-off components quickly and economically.

The finished articles can now be made in a wide range of material, such as plastic, metal and concrete.

4. Business automation

Business automation or business process automation is the process of applying technology to automating and streamlining complex processes. For example, in a manufacturing environment, raw materials can e automatically delivered to the production line where digitally controlled machinery can make a variety of items as dictated by the needs of eh business and its customers. Warehousing applications are big users of automation. To see an amazon fulfillment centre in operation try this link:

https://www.youtube.com/watch?v=4sEVX4mPuto

Business process automation offers the following benefits:

- Processes are performed more quickly and with greater efficiency.
- More consistent results and fewer errors.
- Switching between products being made is usually easier. In non-automated tasks the people involved in production might have to be changed because a different product might require different skills.
- If menial tasks are automated employees have more time to focus on more demanding tasks.
- Better communication. If processes are performed automatically, up-to-date progress and volume information is available to everyone.
- If processes are performed consistently, then problems can be more easily identified: there is something wrong with the process rather than problems being caused by random people-related errors.

5. Artificial intelligence

Artificial intelligence (AI) is a general term that uses to a number of technologies to make machines 'smart'. It can use techniques such as machine learning, image recognition, speech recognition and deep learning, which uses networks capable of learning unsupervised from data that is unstructured.

One of the recent great successes of AI was a program called AlphaGo, developed by DeepMind, a subsidiary of Google. The program was taught the rules of the game Go, then it proceeded to play thousands of games against itself, gradually learning winning strategies. No human was involved in coaching the program, yet after a relatively short time it became world-beating and managed to discover a number of innovative and unexpected winning moves.

Many organizations are now investing in AI research and applications to automate processes and to enhance, support or replicate human intelligence. The applications are particularly relevant to analytical and decision-making tasks.

For example, AI is now being used in sawmills. Tree trunks arrive at the mill in all sizes and qualities. First AI can grade the wood to decide if it should be used to make planks or to make veneers. Then AI can decide how best to saw up a log into planks of the right size so that there is minimum wastage and major flaws in the original log do not make their way into the finisher product.

In service industries, such as lawyers, thousands of pages of documents and emails can be scanned by AI programs in the hope of finding information useful for a case. This goes further than simply looking for key words. Natural language processing means that AI programs can understand the spoken word and respond to natural questions and requests for information. Contracts can be scanned and potentially contentious clauses identified for teh attention of a human lawyer.

6. The internet of things

This s the concept that many different devices such as room thermometers and motion sensors are connected to the internet and, potentially can then 'talk' to each other.

For example, in agriculture aerial surveys can be carried out to assess the mineral content of different areas of grassland. Self-driven tractors controlled by GPS technology can then spread artificial fertilisers, but can tailor the amounts and types in line with the aerial survey findings. More grass for fewer chemicals. Similarly, cattle routinely wear collars that identify them to farm feeding systems so that each is provided with the correct amount ant type of food depending on age, weight and whether they are in calf.

Logistics companies sometimes have to deliver goods, like food or pharmaceuticals like vaccines, with a guarantee that a maximum temperature has never been breached. Temperature monitors accompanying the goods can be used to track and report on the temperatures throughout the goods' delivery.

The IoT is of great use in work-in-progress tracking. Exactly where is a certain unit on the production line.You have probably used some type of tracking yourself when waiting for a delivery from a company like Amazon. Some logistics companies allow you to 'Track you parcel', not just telling you that it will arrive between 2 and 6, but you can track the delivery vehicle on a map displayed on your computer.

7. Data visualisation

Big data, the information arising from ‘the internet of things’, sophisticated trend analysis and financial models all produce data - and often vast amounts. To make sense of the date, to turn it from data to information means that ways have to be found in which the data can be visualised because we find it easier to:

- understand
- interpret
- make discoveries and
- remember data

If it is presented as charts and diagrams rather then tables of figures. Often, now visualisations are interactive so that when parts of a diagram are clicked on they become animated or will be broken down into more detail.

Although Microsoft Excel has many graphical functions, there are also many specialist packages that facilitate data visualisation.

8. Mobile computing

Laptops, tablets and smartphones can make use of WiFi connections and also often mobile phone connections. This enables data to be sent to and from the device to customers, suppliers, colleagues and web-sites.

Instead of a sales rep having to carry round price lists and product specifications, which might have become out of date, the information can be accessed form the head office computer, along with, perhaps, information about what each customer has recently bought. Inventory can be checked and orders uploaded instantly.

9. How the technologies can work together

Rolls Royce makes jet engines. At one point the engines would be sold then repaired when they broke down. Then they introduced a system called TotalCare that monitored engine performance, during flight continually sent data back to the company so that that targeted servicing could be scheduled. Now they have launched IntelligentEngine that uses artificial intelligence so that engines can learn from their own history and that of other engines. The engines are siad by Rolls Royce to be contextually aware. For example, engine performance is altered by air temperature, humidity and pressure, but these factors can be taken into account when deciding if the engine is performing as well as possible. By maintaining two-way communication between the engine and other parts of the service ecosystem the engine should be able to deal with problems, or alert engineers to problems before the problems actually arise.

10. The power of social media

Note that social media, such as Twitter, greatly increases the speed with which tales of real or alleged poor corporate behaviour are spread. Not only spread, but amplified. If an organisation is thought to have acted unethically or without social responsibility, pressure from the public will soon arrive. Many comments are likely to be from people who have nothing to do with the company at all.

For example: an environmental activists' campaign on Facebook to put pressure on Nestle to abandon the use of Indonesian palm oil because of deforestation needed to plant the palm trees. The result was that Nestle announced plans to eliminate the oil and to reiterate its commitment to sustainable oil.

Note that organisations can also use social media to promote both their products and their ethical beliefs. For example, Innocent (a UK brand that makes smoothies) had success tweeting 'witty' messages about the weather (discussing the weather is a British trait).

Hello. We make healthy drinks and give 10% of our profits to charity,

- Weather update: grey and mild. Like a hippo eating a korma.
- Weather update: bright and blue with a strong chance of Friday.
- Weather update: It's you can see your own breath °C

In addition:

FRUIT & VEG BOOKS

- Grape Expectations
- War and Peas
- A Lettuce's Adventures in Wonderland
- Lord of the Pineapple Rings

No need for any more and you will not face a MCQ on any of these examples!

Chapter 17

DIGITAL STRATEGY

1. The economics of digitisation

1.1. Is sophisticated IT needed?

Not all businesses can make the same use of IT or need the same proportion of expenditure on it.

Two sets of questions can be asked:

- What is the current strategic importance of digital technology and what might the future importance be of that digital technology? Support? Turn-around? Strategic?
- What is the 'information intensity' of the business? Digital technology deals with information and the information needs of the business depend on the product and the processes needed to make that product.

1.2. Costs and benefits

The economic justification of digitisation depends on the balance of costs and benefits. In general, costs are fairly easy to measure because most are tangible: cost of hardware, software development, salaries of web-designers, cost of web-hosting services etc. There can be some intangible costs that are difficult to estimate, such as the reputational damage that would occur if the organisation's site were hacked and sensitive data disclosed.

Benefits are much more difficult to estimate. There might be some tangible benefits such as labour cost savings if a warehouse were automated, but many benefits will be difficult to quantify with any confidence. For example:

- Better inventory control will mean fewer stock-outs, hence better customer service. That means the company will have a better reputation and sales and profit should therefore grow. But by how much?
- A more engaging website and better social media management will improve company recognition, build brand loyalty and customer interaction, but how would a company quantify that?
- Greater integration of ordering, payment and dispatch (as found in Amazon's 'One-click buy') will save tangible picking and packing costs but will also attract customers because of its convenience. How can the effect be estimated?
- Investment in IT and digitisation is expensive and this ought to be justified in some way, perhaos through:
- Arguing that market share is being lost to more tech-savvy competitors and it is either invest or die.
- Observing competitors' operations.
- Surveying customer attitudes: do they think our systems and services are poor? What added functions would they like to see us offer?

- Running pilot operations, perhaps on one country or region, and measuring the effect there.
- Making 'blue-sky' estimates.
- Employing someone from a competitor who understands the effect digitisation had there.
- Asking IT consultants for their opinion - but they are unlikely to say that more IT is pointless.

1.3. Feasibility study and project plans

Before major IT expenditure is embarked upon it is *essential* to perform a feasibility study and also to draft a project plan:

Feasibility study

This should cover:

- Economic feasibility (costs v benefits, but as noted above, benefits can be hard to quantify)
- Technical feasibility (will it work?)
- Operational feasibility (will it allow staff, customers and suppliers to easily do what they want to do?)
- Social feasibility (will it be popular? Will staff, customers and suppliers want to use the new system?)

Project plan

- This should cover:
- The scope of the project. *Precisely* what will the system do? *Precisely* what are the deliverables? Poor scope definition is the reef upon which many, perhaps most, IT projects founder. The project starts with a simply ambition, but then is expanded without regard to cost, benefit or the redoing of previous work.
- Cost - the budget
- Time - dates by which elements of the project are to be completed
- Quality - performance metrics to be achieved.

2. Measurement of IT success

It is important to try to measure the success of IT projects. If they are less beneficial that forecast then the forecasting methodology has to be investigated and corrected for next time.

2.1. Transaction processing systems

These systems include:

- Ordering inventory
- Processing sales
- Delivering goods
- Collecting receivables
- Paying wages and salaries
- Many of the changes a new system creates are relatively easy to measure retrospectively (very different to predicting what a system will do). So inventory levels, collection periods, employment costs within the accounting department are all easy measures. Surveys can be conducted too, such as comparing before and after customer satisfaction with delivery times.

2.2. Management information systems and decision support systems

In these areas measuring success can be more difficult as objective measures are hard to find. However, possible metrics include:

- The speed of dealing with queries and requests for information
- Speed of making decisions
- Time taken to generate reports
- Staff ratings of the new system
- It is likely to be very difficult to assess the benefit arising from decisions made using a new system: you simply don't know hat outcomes the old system might have produced.

2.3. Digitisation

By this, we mean the effectiveness of big data, social media presence and effectiveness of the website.

The key performance measures of a business making high use of digital technology include not only financial metrics but also metrics of user engagement. Increasingly, the industry talks about 'digital traction'. 'Traction' in this context means 'grip': does a visit to a web-site end quickly or does it provoke a sales transaction, a future visit, a comment, a customer registration? If none of these are triggered, traction is low and the web-site visit benefits the company very little.

Traction can be measured under three headings: scale, active usage and engagement (World Economic Forum)

Scale

- Unique visitors
- Number of visitors
- Number of registered users
- Month-in-month growth in registrations
- Organic user acquisition (the increase in users not reliant on paid advertising)
- Active usage
- Daily/monthly active usage
- Number of active users
- Conversion rate (rate that users go from one stage to the next)
- Abandon rate (eg the number of 'Unsubscribes')
- Engagement
- Metrics include:
- Time on site/time in app
- Bounce rate (the percentage of visitors to a website who navigate away after viewing just one page).
- Screenflow. Analysis can show common user pathways. In particular it is useful to identify any screens which immediately precede a large number of exits from the site. Perhaps the screen in confusing, unwelcoming, intrusive or displays off-putting information.
- Stickiness: how addictive is the app or site? Is it habit-forming? A frequently used measure is:

  Stickiness = average daily active unique users/monthly active unique users

  So, if 9,000 unique users visit a site each month, but only about 300 visit each day, that means on average each user visits once per month (9,000/30). If, however, there were 9,000 visits per day and 9,000 per month, everyone seems to be visiting once per day

- Cohort retention. For example:

Time period	User visits	Revisit rate
Four months ago	10,000	30%
Three months ago	12,000	27%
Two months ago	12,500	24%
One month ago	13,000	14%
Current	13,500	0%

Analysis is quite complex. The table above does not mean that the website is becoming less engaging because the 30% revisit rate for the four months ago cohort will partly depend on visitors having four months to visit again. The one month ago figure of 14% might simply mean that these visitors have not yet got round to visiting again.

- Downloads
- Average page views per visit
- Customer satisfaction. For example, a measure such as Net Promotor Score is used. Surveys are sent out to customers asking if they would recommend the site to others. Replies are given on a scale of 0 - 10:

  9 - 10 = promoter

  7 - 8 = passive

  0 - 6 = detractor

  NPS = % of promoters - % of detractors

- Time on site
- Posts contributed
- Pictures/videos uploaded
- Number of 'likes' and 'shares'
- Churn rate: the annual percentage rate at which customer stop visiting a site

Chapter 18

BUSINESS ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

1. Business ethics

The **ethical stance** is the extent to which an organisation will exceed its minimum obligations to stakeholders and society at large. (Johnson, Scholes and Whittington).

Ethics, in general, are about what is right and wrong and what is wrong. How should an organisation and its employees make decisions about which actions are acceptable and which aren't? To what extent is it permissible to give gifts to customers? Small amounts of entertainment might be acceptable but at some point the gift might be so lavish that is obviously bribery. To what extent should an organisation tell everything about a product's defects? At some point the response will change from normal 'talking-up' to misrepresentation. For example, recently Volkswagen has been found to have been reporting emission data incorrectly for both marketing and regulatory purposes.

Examples of ethical dilemmas that could easily face organisations include

- Relocating operations or cutting the work-force numbers. Damages current employees but might be god for shareholders and to ensure better job security for future employees.
- How to deal with the environmental impact of operations. In the UK there are currently controversies about fracking and the use of GM crops.
- How to deal with damage caused by the organisation. To what extent should compensation be paid to airline passengers if a flight is cancelled?
- At what price should valuable pharmaceuticals be sold to patients and hospitals?

2. Why ethics are important

Many people and stakeholders regard ethical behaviour as essential because they want the organisation they are connected with to act morally. But not everyone is likely to agree on what the moral or ethical principles are. Fortunately, in business, much of the difficult and controversial issues of ethics can be ignored by simply focussing on the financial impact of unethical behaviour. In other words, it can be argued that good ethics increases company profit.

This claim rests on the assumption that unethical behaviour is usually discovered. This is increasingly likely now that the internet can easily and quickly be used to distribute information, possibly leaked or hacked, such as photographs and documents. Whistle-blowing by employees has become increasingly acceptable and the whistle-blower is now often given legal protection if the leak was in the public interest.

Therefore ethical behaviour will:

- Enhance the organisation's reputation. This will attract more customers, better employees and business partners. Customers and suppliers also prefer to deal with organisations they can trust. If they do not trust the organisation they will fear that there is bad news waiting to be made public.
- Minimise financial damages, legal and regulatory penalties. All organisations make errors from time-to-time: that is part of the risk of doing business. However, the financial consequences of these are likely to be smaller if the organisation did not act negligently to start with and that it owned up to problems quickly and honestly. For example, certainly pharmaceutical firms covered up the side effects that some of their products had. Some patients suffered as a consequence and when the cover-ups were discovered there were massive punitive damages awarded against the companies.
- Good ethics must mean lower risk and lower risk means that finance can be raised more cheaply.
- Cheaper finance means higher present values on projects and higher share prices.

3. Ethical stances

There are four possible ethical stances:

- **Short-term shareholder interest**

  The company limits its ethical stance to taking responsibility for short-term shareholder interests. It expects government to take care of corporate governance and social responsibility issues. The company will follow the laws but no more, and will seek to maximise shareholder wealth in the short term. This might be at the expense or exploitation of other stakeholders

- **Long-term shareholder interest**

  A company might expect to gain advantages from concentrating on long-term shareholder interests. This will often require the company to form closer relationships with other stakeholders. For example, being cooperative with customers returning goods because of no-quibble refunds will help their long-term reputation and growth.

  Other examples include:

  - Avoiding 'shady' marketing practices such as high-pressured sales techniques.
  - Sponsoring local charities.
  - Providing work experience for local school-leavers
  - Adopting ecologically sound ('green') policies.

- **Multiple stakeholder obligations**

  This stance emphasises the interests of all stakeholders rather than just shareholder interests. Companies taking this view see the need for incorporating stakeholder interests and expectations in the organisation's purposes and strategies beyond the minimum legal obligations e.g. keeping uneconomic jobs open, paying well above normal wage rates. The difficulty with this stance is finding where how to balance multiple stakeholder's interests.

- **Shaper of society**

  The fourth stance is ideologically driven and financial considerations become secondary to shaping society. This approach is better suited for privately owned companies as they are not accountable to public external shareholders.

  An example might be found in companies whose purpose is to give 'micro-loans'. Microlending is the practice of granting small loans to people in need. These loans are generally used by entrepreneurs who are starting a business, or those who need extra cash to expand. Microlending is unique because of the motivation behind it, the size of loans, and the people involved. Traditional mainstream lenders are solely charging interest (and possibly fees) that cover their costs. Microlenders are more interested in *development*. Their main goal is to help small entrepreneurs who would otherwise not be able to borrow. He lenders might also provide coaching and training (they teach these entrepreneurs how to run a successful business, as opposed to just lending money and letting borrowers fend for themselves).

4. Corporate social responsibility

A popular definition of corporate social responsibility (CSR) is:

'the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large'.

CSR is related to ways in which organisations exceed their minimum obligations to stakeholders as specified by regulation and corporate governance.

Common features associated with CSR include:

- an integration of social concerns into business operations
- voluntary actions on behalf of the organisation
- operating in ways that exceed ethical, legal and societal expectations
- making a positive difference to society.

For example, and organisation could:

- Pay all workers well about the minimum legal wage
- Go further than required to reduce pollution and its carbon foot-print
- Provide excellent health care for staff
- Provide child-minding for staff.

Although CSR is currently a fashionable issue for organisations to pursue it is important to point out some potential difficulties with large-scale CSR:

Directors and managers have a legal duty to their company's shareholders to maximise shareholders' wealth. What legal right have directors to decide that a company should suddenly start spending shareholders' money lavishly on CSR projects picked by the directors?

How do directors decide on which CSR projects money should be spent. Are they simply spending money on areas that are of interest to them?

Companies spending generously on CSR reduce their profits and reduce the government's tax income. Perhaps the government is better placed to legislate and to spend money on society. Governments are elected by all the people and can allocate money more logically across many requirements.

If shareholders really want to contribute more, they can make personal charitable donations to wherever they please out of their dividends.

Justification of CSR depends on the amounts spent on it. There would be no problem with carefully directed amounts being spent to generate good public relations or staying on good terms with people living nearby. These amounts can easily be justified by hard-headed business decisions. Similarly, providing child care facilities for staff could be an important way to attract and retain good employees who might otherwise find it impossible to go out to employment.

However, if an organisation begins spending higher amounts on CSR than can be justified in terms of expenditure needed for the long-term maximisation of shareholder wealth (for example, public relations, attracting good employees, avoiding regulation) then the directors are probably acting controversially and perhaps even illegally.

5. Corporate governance

Corporate governance is a system by which companies are directed and controlled.

The problem is that although the shareholders own companies, the day-to-day management and direction of companies is given to the Board of Directors. In large companies, many shareholders are relatively passive and the Board of Directors are given more or less free rein to make whatever decisions they wish. This can have adverse consequences for all other stakeholders. For example:

- Shareholders' profits might be lower if directors take unwarranted risks or pay themselves too handsomely.
- Employees are treated harshly.
- Suppliers of goods and services might be cheated.
- The local populace can be harmed by the organisation's activities.
- Corporate governance rules have therefore been brought in by many countries to try to ensure that companies are more reliably and more ethically directed and controlled. The Organisation of Economic Cooperation and Development states (amongst other provisions) that corporate governance should:
- Recognise the rights of all *stakeholders,* not just shareholders, end encourage active cooperation between the entities and stakeholders creating wealth, jobs and sustainability of financially sound enterprises.
- Ensure the strategic [ie long-term] guidance of the entity, effective monitoring of management by the board and the board's accountability to the entity and their shareholders....
- Therefore:

  The corporate governance framework and procedures.....

  ...oversee and control the behaviour of directors and the board....

  ....to ensure ethical behaviour...

  ....and which must recognise the rights of all stakeholders...

  ...for the long-term (strategic) success of the company